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**Status:** Final**Effective date:**From 1st December 2005 to 1st January  
2009**Accounting impact:**

Profit, net assets and disclosure



# International Financial Reporting Bulletin

New and revised standards and interpretations in issue at 31st December 2006

## Background

A number of new standards are now in issue that were not part of the “stable platform” used by companies adopting IFRS in 2005. Some of these new standards and interpretations must be adopted for annual periods commencing 1st January 2006, while others are not mandatory until 2008 or 2009.

New standards and interpretations may be adopted early, although early adoption must be disclosed. Where new accounting standards or interpretations that are not yet mandatory are not adopted early, IAS 8 requires disclosure of the possible effect that their application might have on the financial statements.

However, we are currently in another period of relative stability. The IASB has announced that it will not require any new standards (or major amendments to existing standards) to be adopted before 1 January 2009, but some minor amendments and IFRICs may have earlier adoption dates.

In some jurisdictions, such as the EU, adoption must await local professional or legal approval. The current status of these standards for EU companies is discussed at the end of this bulletin.

## New and revised standards effective for 31st December 2006 year-ends

	<i>New Standard</i>	<i>Effective for annual periods commencing on or after</i>
IFRS 6	Exploration for and Evaluation of Mineral Resources	1st January 2006
<i>Amendments</i>		
IAS 19	Employee Benefits	1st January 2006
IAS 39	Financial Instruments: Recognition and Measurement	1st January 2006
IAS 21	Net investment in a Foreign Operation	1st January 2006
<i>Interpretations</i>		
IFRIC 4	Determining whether an Arrangement contains a Lease	1st January 2006
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	1st January 2006
IFRIC 6	Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	1st December 2005

**New and revised standards in issue but not effective for 31st December 2006 year-ends**

<i>New Standards</i>		<i>Effective for annual periods commencing on or after</i>
IFRS 7	Financial Instruments: Disclosures	1st January 2007
IFRS 8	Operating Segments	1st January 2009
<i>Amendment</i>		
IAS 1	Amendment – Capital Disclosures	1st January 2007
<i>Interpretations</i>		
IFRIC 7	Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1st March 2006
IFRIC 8	Scope of IFRS 2	1st May 2006
IFRIC 9	Reassessment of Embedded Derivatives	1st June 2006
IFRIC 10	Interim Financial Reporting and Impairment	1st November 2006
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions	1st March 2007
IFRIC 12	Service Concession Arrangements	1st January 2008

**New and revised standards effective for 31st December 2006 year-ends**

*New Standard*  
**IFRS 6 Exploration for and Evaluation of Mineral Resources**

IFRS 6 applies to the recognition and measurement of exploration and evaluation assets for extractive industries.

Its scope is confined to the period between:

- the granting of a legal right to explore an area; and
- the point at which the technical feasibility and commercial viability of extracting mineral resources are demonstrable.

The IASB is undertaking major research in to accounting for extractive industries generally, and IFRS 6 is designed as a temporary measure before a completely new standard is produced. Therefore, it has not set out strict recognition and measurement rules that would have to be amended at a later date.

Key elements of this approach are:

- It allows an entity to continue with its existing accounting policies for recognising and measuring exploration and evaluation assets, provided that they comply with the requirements of IAS 8 to be relevant and reliable for decision making.

- Exploration and evaluation assets are treated as a separate class of asset, and the accounting policy for recognising and measuring these assets is required to be disclosed.
- The criteria for identifying when impairment reviews are required are relaxed, owing to the difficulty of obtaining relevant information. However, impairment reviews must take place:
  - when the technical feasibility and commercial viability of extracting resources is demonstrable (at which point the assets are reclassified as tangible or intangible assets under IAS 16 or IAS 38); and
  - when facts and circumstances suggest that the carrying value is greater than its recoverable amount.

### *Amendments to standards*

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#### **IAS 19 Employee Benefits**

This amendment affects three areas:

- actuarial gains and losses,
- group schemes, and
- disclosures.

#### *Actuarial gains and losses*

Actuarial gains and losses arising on defined benefit plans can now be accounted for in three ways:

- To the extent that actuarial gains and losses exceed the greater of 10% of the defined benefit obligation and the fair value of plan assets, the excess can be amortised to the income statement over the expected average remaining working lives of the employees;
- Actuarial gains and losses can be recognised in the income statement using any systematic basis that results in faster recognition than the method outlined above, provided that it is applied consistently; or
- The full amount of actuarial gains and losses can be recognised immediately in the statement of recognised income and expense as set out in IAS 1 paragraph 96 (a new option effective from 1st January 2006).

The new option permits a practice that is common in some jurisdictions under local GAAP.

#### *Group plans*

Some group defined benefit schemes share the risks between entities under common control. In these cases the following requirements apply:

- The accounts of entities within a group should reflect information about the group plan as a whole.

- In the individual financial statements the costs of the plan will be apportioned as follows:
  - In accordance with a contractual agreement between the companies, if one exists; or
  - In the absence of an agreement then the sponsoring company bears the full cost of the plan. In these situations the other companies in the group will each charge the contributions payable by them for the period.

It should be noted that group plans are different from multi-employer plans, where assets contributed by a number of entities are pooled. In such cases all entities are required to account for the scheme as a defined benefit scheme unless the required information cannot be obtained (see IAS 19 paragraphs 7, 29, 30, 32, 32A and 32B4).

*Disclosures* Additional disclosures are required to:

- Provide information about the trends in the assets and liabilities of a defined benefit scheme, and of the assumptions behind the cost of the scheme; and
- Bring the disclosures closer to those required by SFAS 132 Employers' Disclosures about Pensions and Other Postretirement Benefits.

### **IAS 39 Financial Instruments: Recognition and Measurement**

#### *Hedge accounting for forecast intra- group transactions*

There are three amendments to this standard.

In consolidated accounts, the foreign currency risk of an intra-group forecast transaction can act as the hedged item in a cash flow hedge provided that:

- it is highly probable;
- the transaction is not in the functional currency of the transacting party; and
- the currency risk will affect the consolidated financial statements.

Gains and losses recognised in equity in accordance with the rules of IAS 39 are transferred to the income statement when the foreign currency risk of the hedged transaction affects the consolidated income statement.

#### *Restrictions on the fair value option*

In the past, IAS 39 allowed any financial instrument to be designated as at "fair value through profit or loss". The amendment restricts the use of "fair value through profit or loss" to the following categories and circumstances:

- Instruments classified as held for trading (which are those held for short term – ie no more than a few days – profit taking, and derivatives).
- Where the use of the fair value option eliminates or significantly reduces an accounting mismatch where assets and liabilities, or gains and losses on them, are accounted for on different bases.

- Where a group of financial assets, financial liabilities, or both is managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy.
- Where a contract contains one or more embedded derivatives, unless the derivatives do not significantly modify cash flows or it is clear that separation is prohibited.

Financial instruments must be designated as at fair value through profit or loss on initial recognition and subsequent transfer to a different category is prohibited.

*Financial guarantee contracts and credit insurance*

This affects the application of IAS 39 and IFRS 4 *Insurance Contracts* in financial statements.

All financial guarantee contracts are within the scope of IAS 39. However, if a financial guarantee contract has previously been designated and accounted for as an insurance contract then the issuer can opt to apply either IAS 39 or IFRS 4. The choice is made on a contract by contract basis, but it is irrevocable.

In order to use the option to apply insurance accounting, the issuer of the financial guarantee contracts must previously have asserted explicitly that it regards such contracts as insurance contracts and that it uses accounting applicable to insurance contracts.

The IASB sees this amendment as a “temporary practical solution” that reduces the risk that financial guarantees will be omitted from the balance sheet altogether. It is currently undertaking research into accounting for insurance contracts in general.

**IAS 21 – Net investment in a Foreign operation - Amendment**

IAS 21 allows exchange differences on long-term loans from a parent to a foreign-currency subsidiary that form part of the parent’s net investment in the subsidiary to be classified as a separate component of equity in the consolidated financial statements, rather than as a profit or loss. The amendment extends this treatment to long-term loans between fellow subsidiaries. The loan can now be in any currency (other than the functional currency of the parent).

This amendment affects the consolidated accounts only; the treatment in individual accounts is unchanged, with all exchange differences being recorded in the income statement.

*Interpretations*

**IFRIC 4 Determining whether an Arrangement contains a Lease**

This interpretation addresses transactions that do not take the legal form of a lease, but convey the right to use an asset in return for a series of payments. The IFRIC gives the following examples:

- outsourcing,
- rights to telecom capacity,

- “take or pay” contracts where purchasers make set payments regardless of whether they take delivery of the related goods or services.

IFRIC 4 provides guidance on

- (a) how to determine whether these arrangements are, or contain, a lease as defined in IAS 17;
- (b) when to assess or reassess an arrangement; and
- (c) how any lease payments should be separated from payments for any other elements in the arrangement.

Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
- (b) the arrangement conveys a right to use the asset.

If the above analysis shows that the arrangement is, or contains, a lease, then both parties account for the lease element of the arrangement in accordance with IAS 17 *Leases*.

### **IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds**

IFRIC 5 relates to funds that are designed to be used to cover future decommissioning costs. They may be voluntary or required by law, and they may be for an individual entity or for a group of entities.

Typical features include:

- (a) A separate fund administered by independent trustees.
- (b) Contributions invested by trustees.
- (c) Contributors retain the obligation to pay decommissioning costs, but are able to claim reimbursement from the fund
- (d) Contributors have restricted access to any surplus.

IFRIC 5 applies to the financial statements of a contributor paying into a decommissioning fund that has both of the following features:

- (a) the assets are administered separately (either in a separate legal entity or as segregated assets within another entity); and
- (b) a contributor's right to access the assets is restricted.

The issues addressed are:

- (a) how a contributor should account for its interest in a fund; and
- (b) how an obligation to make potential additional contributions (for example if another contributor becomes bankrupt) should be accounted for.

The normal accounting treatment by a contributor is as follows:

- the obligation to pay decommissioning costs is recognised as a liability;
- an obligation to make potential additional contributions is disclosed as a contingent liability; and
- the interest in the decommissioning fund is recognised separately as an asset.

The asset is accounted for in one of two ways:

- If the contributor has control, joint control or significant influence over the fund then it is accounted for by reference to IAS 27, IAS 28, IAS 31 and SIC-12.
- If IAS 27, IAS 28, IAS 31 or SIC-12 do not apply, then the right to receive reimbursement is recognised in accordance with IAS 37. This is measured at the lower of:
  - the decommissioning obligation recognised; and
  - the contributor's share of the fair value of the fund.

Changes in the carrying value of the right to reimbursement (other than payments to or from the fund) are recognised in profit or loss for the period.

### **IFRIC 6 Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment**

The European Union's Directive on Waste Electrical and Electronic Equipment (WE&EE) deals with the cost of decommissioning historical household waste. "Historical" waste relates to products sold before 13 August 2005. Under the Directive the cost of decommissioning historical household equipment is borne by producers in proportion to their participation in the market during a "measurement period".

The measurement period will be determined by each Member State, therefore the liability will be measured differently in each State. Also, the measurement period giving rise to the obligation may not bear any similarity to market shares when the waste goods were originally sold. For example, a manufacturer entering the market after August 2005 may be liable for waste produced in previous years, while a major manufacturer who left the market before the measurement period will bear no liability.

The consensus is as follows:

- The obligating event is participation in the market during the measurement period
- The events giving rise to the liability do not relate to:
  - the actual production or sale of the products to be disposed of; or
  - the costs of the related waste management process.

The Directive and the IFRIC only address historic, domestic waste. However, if individual countries extend the provisions to new and/or non-domestic waste then the principles in the IFRIC will still apply.

### **New and revised standards in issue but not effective for 31 December 2006 year-ends**

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Standards, amendments and interpretations in issue at 31st December 2006 but not yet effective are summarised below.

These may be adopted early, subject to local legal requirements (the requirements for EU entities are summarised at the end of this paper.) Early adoption must be disclosed in the financial statements. If an entity decides not to apply a standard that has been published but has not yet come into force, then IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires the entity to estimate and disclose the effects of adopting that standard in the future.

The disclosure should consider the following points:

- Title of the new standard;
- Nature of the future changes;
- Date by which the new standard must be applied;
- Date from which the entity intends to apply the new standard;
- Discussion of the impact of the initial adoption, or a statement that this cannot be estimated.

#### *New Standards*

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#### **IFRS 7 Financial Instruments: Disclosures**

IFRS 7 is effective for periods beginning on or after 1 January 2007. This is a disclosure standard, and so adoption will not affect reported profits. If adopted early, then the extra guidance included in IFRS 4 *Insurance Contracts* must also be implemented.

IFRS 7 combines the disclosure requirements of IAS 30 and IAS 32 into one standard. As a result it amends other standards as follows:

- It replaces the specific disclosures for banks in IAS 30.
- It replaces the disclosure requirements formerly found in IAS 32.
- The capital disclosures required by IAS 1 are amended (see below).

The presentation requirements of IAS 32 are unchanged and remain in force.

Under IFRS 7 financial instruments are grouped together into classes of similar instruments. Detailed disclosures are then made based on these classes. The disclosures in IFRS 7 enable users to evaluate:

- (a) the significance of financial instruments for the entity's financial position and performance; and
- (b) the nature and extent of risks arising from financial instruments to which the entity is exposed, and how the entity manages those risks.

The scope of IFRS 7 is broader than its predecessors:

- With a few exceptions (see below) IFRS 7 applies to all financial instruments of all entities. However, the level of disclosure depends on the use of financial instruments and the exposure to risk.
- It also applies to unrecognised financial liabilities such as loan commitments and to contracts to buy or sell certain non-financial items.

IFRS 7 does not apply to the following financial instruments:

- (a) Subsidiaries, associates and joint ventures consolidated in accordance with IAS 27, IAS 28 or IAS 31. However it does apply to interests in subsidiaries, associates or joint ventures accounted for under IAS 39. It also applies to any related derivatives.
- (b) Rights and obligations accounted for under IAS 19 Employee Benefits.
- (c) Acquirer's contracts for contingent consideration in a business combination.
- (d) Insurance contracts accounted for under IFRS 4 Insurance Contracts.
- (e) Financial instruments, contracts and obligations accounted for under IFRS 2 Share-based Payment.

## **IFRS 8 Operating Segments**

IFRS 8 is effective for periods beginning on or after 1st January 2009. Although it has not yet been endorsed by the EU, endorsement has been recommended by EFRAG. It replaces IAS 14.

This is a disclosure standard, and so adoption will not affect reported profits.

The objective of IFRS 8 is to disclose information to enable users to evaluate the nature and financial effects of the business activities in which an entity engages and the economic environments in which it operates.

IFRS 8 aims to view the entity's performance through the eyes of the "Chief Operating Decision Maker". The term "Chief Operating Decision Maker" refers to a function, not necessarily an individual. Consequently it may be the chief executive officer or chief operating officer; alternatively it may be a group of directors. The disclosures are based on the management reports used by the chief operating decision maker to allocate resources and assess performance. Segments are based on the reporting components identified by management, and the reports are drawn up using the management's own internal accounting policies rather than those used for the statutory accounts.

As before, reportable segments are based on a size criteria. These are that a segment should be reported if it exceeds one or more of the following:

- 10% of total segment revenues, both internal and external; or
- 10% of total segment profits, or 10% of total segment losses; or
- 10% of assets.

In a change from IAS 14, operating segments generating most of their revenues from internal trade may still qualify as reporting segments. Internal sales are taken into account when identifying reportable segments to assist users in understanding how the business is integrated.

As a minimum the segment report will disclose net profit and total assets, but it will also include revenues, interest income, interest expense, amortisation, depreciation, share of associates and joint ventures, tax, liabilities, investments, and additions to non-current assets if these items are included in the management report to the “Chief Operating Decision Maker”.

There is no longer a requirement for two sets of reports based on product and on location. However, some additional entity-wide disclosures must be made. These are:

- A geographical break-down of revenues and non-current assets by:
  - Country of domicile, and
  - All other countries. Any material countries should be disclosed separately.
- Customers accounting for more than 10% of external revenues should be disclosed.
  - For the purpose of this disclosure, a group of customers under common control is counted as one.
  - The name of the customer need not be disclosed.

The disclosure requirements for interim reports have also been increased.

### *Amendments to standards*

#### **IAS 1 – Presentation of Financial Statements - Amendment to Capital Disclosures**

Effective for periods beginning on or after 1 January 2007.

This is an amendment to disclosure requirements, and so adoption will not affect reported profits.

New capital disclosure requirements have been implemented by issuing IFRS 7 (see above) and by amending IAS 1 *Presentation of Financial Statements*. IAS 1 now requires entities to disclose:

- (a) the entity’s objectives, policies and processes for managing capital;
- (b) quantitative data about what the entity regards as capital;

- (c) whether the entity has complied with any capital requirements; and
- (d) if it has not complied, the consequences of such non-compliance.

The amendment includes guidance and illustrative examples of the disclosures required.

### *Interpretations*

#### **IFRIC 7 Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Economies**

Effective for periods beginning on or after 1st March 2006.

Adopting this standard will affect reported profits and the presentation of assets and liabilities.

IFRIC 7 provides guidance on how to apply IAS 29 in the first period that hyperinflation is identified in the functional currency, and on how to restate the prior period financial statements.

In the first period of hyperinflation IAS 29 is applied as if the economy has always been hyperinflationary. Non-monetary items measured at historical cost at the start of the earliest period being presented are restated to reflect inflation from the date of acquisition up to the closing balance sheet date of the reporting period.

Deferred tax in the opening balance sheet is restated as follows:

- Deferred tax is remeasured using the revised carrying values calculated above.
- This revised value for deferred tax is then restated for the change in the measuring unit from the opening balance sheet date to the closing balance sheet date.

#### **IFRIC 8 Scope of IFRS 2**

Effective for periods beginning on or after 1 May 2006.

Adopting this IFRIC may affect reported profits and the presentation of assets, liabilities and equity.

IFRIC 8 confirms that IFRS 2 applies to transactions where the identifiable consideration received (or to be received) appears to be less than the fair value of the equity instruments granted or liability incurred. This indicates that other consideration (i.e. unidentifiable goods or services) have been (or will be) received.

These situations are accounted for as follows:

- The identifiable goods or services received are measured in accordance with IFRS 2.
- The unidentifiable goods or services received (or to be received) are measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).

### **IFRIC 9 Reassessment of embedded derivatives**

- The unidentifiable goods or services received are measured at the grant date.
- For cash-settled transactions, the *liability* is re-measured at each reporting date until it is settled.

Effective for periods beginning on or after 1st June 2006.

Adopting this IFRIC may affect reported profits and the presentation of assets, liabilities and equities.

Under IAS 39 when an entity enters into a contract containing one or more embedded derivatives it assesses whether these derivatives should be separated from the host contract and accounted for separately.

IFRIC 9 addresses the following issues:

- (a) Should the assessment be made only when the entity first becomes a party to the contract, or should it be re-assessed throughout the life of the contract?
- (b) Should a first-time adopter make its assessment on the basis of the conditions that existed when the entity first became a party to the contract, or those prevailing when the entity adopts IFRSs?

The requirements are as follows:

#### *Reassessment*

- The assessment as to whether a derivative should be separated from its host contract and accounted for as a derivative is made when the entity first becomes a party to the contract.
- Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required

#### *First time adoption*

- A first-time adopter assesses whether an embedded derivative is required to be separated from the host contract on the basis of conditions that existed when it first became a party to the contract.
- A remeasurement is only carried out if there is a change in the terms of the contract.

### **IFRIC 10 Interim Financial Reporting and Impairment**

Effective for periods beginning on or after 1st November 2006, but not yet endorsed by the EU.

Adopting this IFRIC may affect reported profits and the presentation of assets.

The issue addressed by IFRIC 10 is an apparent conflict between IAS 34 Interim Financial Reporting, and IAS 39 Financial Instruments: Recognition and Measurement and IAS 36 Impairment of Assets.

IAS 36 and IAS 39 require an entity to assess goodwill, and investments in equity instruments and financial assets, for impairment at each balance sheet date. IAS 34 requires the application of the same accounting policies in interim financial statements as in annual financial statements. It also notes that the frequency of an entity's reporting (quarterly, half yearly or annual) should not affect the measurement of its annual results.

Impairments of goodwill are prohibited from being reversed, while impairments of equity investments and other financial assets classified as Available for Sale are prohibited from being reversed through the income statement. In consequence, it would appear possible for an entity that reports half yearly, where certain of its assets are impaired at the half year but where that impairment has reversed by the financial year end, to report different amounts in its annual financial statements in comparison with an entity that reports only on an annual basis.

The IFRIC concluded that the guidance for impairment set out in IAS 36 and IAS 39 should take precedence over the guidance in IAS 34, and that it would be possible for the frequency of reporting to affect amounts reported in annual financial statements.

It should be noted that IFRIC 10 states specifically that the consensus reached should not be applied to any other areas of conflict between IAS 34 and other standards.

### **IFRIC 11 – Group and Treasury Share Transactions**

Effective for periods beginning on or after 1 March 2007, but not yet endorsed by the EU.

IFRIC 11 provides guidance as to whether certain share-based payment transactions should be classified as equity settled or cash settled.

Adopting this IFRIC may affect which member of a group bears the cost of a share-based payment transaction and the presentation of liabilities and equity.

Three situations are addressed.

- 1 An entity grants rights in its own equity instruments to its employees. The entity either chooses or is required to buy the equity instruments from another party in order to satisfy its obligations.

The consensus is that any share-based payment transactions in which an entity receives services as consideration for its own equity instruments is accounted for as equity-settled.

This applies regardless of whether the entity:

- chooses or is required to buy those equity instruments from another party; or
  - the employee's rights were granted by the entity itself or by its shareholder(s); or
  - the arrangement was settled by the entity itself or by its shareholder(s).
- 2 A parent grants rights to its equity instruments directly to the employees of its subsidiary. The parent (not the subsidiary) has the obligation to provide the employees of the subsidiary with the equity instruments.

The consensus is that, provided that the arrangement is accounted for as equity-settled in the consolidated financial statements, the subsidiary accounts for the services received as an equity-settled share-based payment transaction. The corresponding increase in equity is recognised as a contribution from the parent.

- 3 A subsidiary grants rights to equity instruments of its parent to its employees. The subsidiary (not the parent) has the obligation to provide its employees with the equity instruments.

The consensus is that, in its own accounts, the subsidiary accounts for the transaction with its employees as a cash-settled share-based payment transaction because the share-based payment is not over its own equity instruments. This requirement applies irrespective of how the subsidiary obtains the equity instruments to satisfy its obligations to its employees.

### **IFRIC 12 Service concession arrangements**

Effective for periods beginning on or after 1st January 2008, but not yet endorsed by the EU.

In some countries, governments have introduced contractual service arrangements to attract private sector participation in the financing, development, operation and maintenance of infrastructure.

IFRIC 12 is the output from one of the longest and most demanding projects undertaken by the IFRIC. It interprets 14 IFRSs and amends two others, with the main text being accompanied by two appendices, two information notes, three illustrative examples and a lengthy basis for conclusions.

The interpretation refers to the entity that awards the concession as the grantor and the entity that provides the services as the operator.

An arrangement within the scope of IFRIC 12 typically involves a the operator constructing or upgrading the infrastructure used to provide the public service, and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the management.

Other common features are:

- (a) the grantor is a public sector entity and the operator is a private sector entity;

- (b) the operator is responsible for at least some of the management and is not merely an agent of the grantor;
- (c) the contract sets the initial price and regulates price revisions over the period of the arrangement; and
- (d) the operator is obliged to hand over the infrastructure to the grantor at the end of the arrangement, for little or no consideration.

The specific scope of IFRIC 12 covers public-to-private service concession arrangements where:

- (a) the grantor controls or regulates the services provided by the operator; and
- (b) the grantor controls any significant residual interest in the infrastructure at the end of the arrangement.

IFRIC 12 specifies the treatment to be followed by the operator, not by the grantor, and addresses the following issues:

- Treatment of the operator's rights over the infrastructure;
- Recognition and measurement of consideration;
- Construction or upgrade services;
- Operation services;
- Borrowing costs;
- Subsequent accounting of a financial assets and an intangible asset; and
- Items provided to the operator by the grantor.

In the financial statements of the operator, service concession arrangements are accounted for as follows:

***Infrastructure assets*** Infrastructure assets are not recognised as plant, property and equipment, as those assets are not controlled by the operator. Instead, depending on the terms of the arrangement, the operator recognises either a financial asset or an intangible asset (or both).

***Financial assets*** A financial asset is recognised to the extent that the operator has an unconditional right to receive cash or another financial asset from, or at the discretion of, the grantor for the construction services. This will be the case where the grantor guarantees to pay the operator either a) specified or determinable amounts, or b) the shortfall, if any, between the amounts received from users of the public service and specified or determinable amounts. This will be the case even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

*Intangible asset* An intangible asset is recognised to the extent that the operator receives a right to charge users of the public service (i.e. a licence). A right to charge users of the public service is not an unconditional right to receive cash, and therefore is not a financial asset, because the amounts are contingent on the extent to which the service is used.

*Construction or upgrade services* Revenue and costs relating to construction or upgrade services are accounted for in accordance with IAS 11.

*Operational services* Revenue and costs relating to operation services are accounted for in accordance with IAS 18.

### Early adoption by EU Companies

Entities applying EU-adopted IFRS should consider whether a standard has been formally endorsed by the EU before adopting it. Normally the “effective” date for an IFRS is sufficiently far in the future that the standard will have been endorsed before it becomes mandatory.

However, if a standard is being adopted early then it may not have been endorsed yet. An unendorsed new standard can be applied by an entity which reports in accordance with EU-endorsed IFRS only if:

- it is consistent with existing endorsed standards, and
- it is consistent with IAS 8 paragraph 10, which requires accounting policies to be relevant and reliable.

In practice this means that:

- An unendorsed new standard replacing an existing standard probably cannot be adopted. The new standard will normally conflict with the existing one it is replacing.
- An unendorsed standard on a new area not previously addressed by an accounting standard might be adopted, provided that it does not conflict with any endorsed standards.

An IFRIC covering the interpretation of an endorsed IFRS can often be adopted early, as it may only interpret existing standards rather than introducing new requirements. However, care is required as transitional arrangements in particular may conflict with existing standards.

The only items that have not been endorsed by the EU as at 5th February 2007 are IFRS 8 *Operating Segments*; IFRIC 10 *Interim Financial Reporting and Impairment*; IFRIC 11 *IFRS 2 Group and Treasury Share Transactions*, IFRIC 12 *Service Concession Arrangements*. These are expected to be endorsed in June or July 2007. For up-to-date information consult the Endorsement Status Report on <http://www.efrag.org>.