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EXAMINATION OF THE CONFORMITY BETWEEN SIC 1 TO SIC 25 AND THE EUROPEAN ACCOUNTING DIRECTIVES

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EXAMINATION OF THE CONFORMITY BETWEEN INTERPRETATIONS OF THE STANDING INTERPRETATIONS COMMITTEE (SIC) OF THE IASC AND THE EUROPEAN ACCOUNTING DIRECTIVES:

SIC 1 – SIC 25

SIC – 1: Consistency – Different Cost Formulas for Inventories[1]

Summary

Paragraphs 21 and 23 of IAS 2 allow various cost formulas (FIFO, weighted average cost of LIFO) for inventories (stocks) that are ordinarily interchangeable or are not produced and segregated for specific projects. SIC – 1 requires that an enterprise should use the same cost formula for inventories having a similar nature and use to the enterprise. In the case of inventories with a different nature or use, different cost formulas may be used.

Conclusion

SIC – 1 is entirely consistent with Article 40 of the Fourth Directive, which states that Member States may permit the purchase price or production cost of stocks of goods of the same category to be calculated either on the basis of weighted average prices or by the FIFO method, the LIFO method, or some similar method.

SIC – 2: Consistency – Capitalisation of Borrowing Costs[1]

Summary

Paragraphs 7 and 11 of IAS 23 allow the choice of either recognising all borrowing costs as an expense in the period in which they are incurred (Benchmark Treatment) or capitalising borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets as part of the cost of that asset (Allowed Alternative Treatment). SIC – 2 requires that if an enterprise has elected to apply the Allowed Alternative Treatment of capitalisation, then that treatment should

[1] Commission document DG MARKT 6053/99

be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets of the enterprise, even if continued capitalisation means a carrying amount of an asset exceeds its recoverable amount. In such cases the asset would be written down to its recoverable amount through the recognition of an impairment loss.

Conclusion

Article 35(4) of the Fourth Directive states that interest on capital borrowed to finance the production of fixed assets may be included in the production costs to the extent that it relates to the period of production, whilst Article 31(1)(b) requires that the methods of valuation must be applied consistently from one financial year to another. Consequently, the requirements of SIC – 2 are entirely consistent with the consistency concept which is embodied in the Fourth Directive.

SIC – 3: Elimination of Unrealised Profits and Losses on Transactions with Associates[1]

Summary

IAS 28 does not give explicit guidance on the elimination of unrealised profits and losses resulting from transactions between an investor company (or its consolidated subsidiaries) and its associates. SIC – 3 requires that where an associate is accounted for using the equity method, unrealised profits and losses resulting from transactions between an investor company (or its consolidated subsidiaries) and its associates should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred.

Conclusion

SIC – 3 is entirely consistent with Articles 31(1)(c)(aa) and (bb) of the Fourth Directive which state that only profits made at the balance sheet date may be included in the annual accounts and that account must be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or of a previous one.

[SIC – 4: withdrawn]

SIC – 5: Classification of Financial Instruments – Contingent Settlement Provisions[1]

Summary

SIC – 5 deals with the issue of how to classify a financial instrument when the manner of settlement (i.e. in cash or in equity instruments of the issuer) depends on the outcome of uncertain future events that are beyond the control of both the issuer and holder. For example, an enterprise could issue shares under settlement terms that are dependent on the level of the issuer's future revenues; if the enterprise does not meet certain revenue goals in one year, then it is required to exchange the shares for debentures.

SIC – 5 states that in such circumstances the shares should be classified in accordance with paragraphs 5 and 18 of IAS 32 as liabilities, regardless of their legal form, unless the possibility of settlement in cash appears to be remote, in which case the instruments should be classified as equity.

Conclusion

SIC – 5 presents a potential conflict with the Accounting Directives that has already been highlighted in the Contact Committee's examination of the conformity between IAS 32 (Revised 1998) and the Directives. The requirement in SIC – 5 to treat certain financial instruments that are legally equity but, according to the criteria in IAS 32, in substance liabilities, as liabilities, is contrary to the balance sheet formats set out in Articles 9 and 10 of the Fourth Directive, which provide a heading for 'Subscribed capital' within the heading 'Capital and Reserves'. Where such shares are issued by a subsidiary, to include them within liabilities in the consolidated accounts would result in a conflict with Article 21 of the Seventh Directive, which requires minority interests to be included as 'a separate item' in the consolidated balance sheet.

In addition, to show shares within liabilities would frustrate the application of the Second Company Law Directive, which *inter alia* sets out rules for the distribution of profits and for action to be taken in the event of a serious loss of capital. These rules are based on relationships between, and multiples of, assets, liabilities and capital and reserves as shown in the accounts. The practical impact of those rules will vary according to whether shares are included within capital and reserves or liabilities.

However, a possible solution to this conflict might be to show such shares, that are required to be classified as a liability under SIC – 5, separately under an additional caption within the major heading 'Capital and Reserves'.

SIC – 6: Costs of Modifying Existing Software[1]

Summary

SIC – 6 deals with the issue of whether the costs in modifying existing software systems may be capitalised and, if not, when such costs should be recognised as an expense. Although the Interpretation is drafted in the context of Year 2000 modification costs, its application extends to software modification costs generally.

SIC – 6 requires that costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems should not be capitalised, but should be recognised as an expense when, and only when, the restoration or maintenance work is carried out.

Conclusion

SIC – 6 is entirely consistent with Article 35 of the Fourth Directive which requires that fixed assets must be valued at purchase price or production cost. It is also entirely consistent with the Fourth Directive that expenditure incurred in order to restore or maintain the future economic benefits that an enterprise expected from the original standard of performance of existing software systems should not be capitalised, but should instead be expensed as incurred.

SIC – 7: Introduction of the Euro[1]

Summary

SIC – 7 deals with the issue of the application of IAS 21 – *The Effects of Changes in Foreign Exchange Rates* – to the changeover from the national currencies of participating Member States of the European Union to the euro. It states that the requirements of IAS 21 regarding the translation of foreign currency transactions and financial statements of foreign operations should be applied strictly to the changeover.

Conclusion

The Contact Committee has previously concluded that there are no conflicts between IAS 21 and the Accounting Directives. Consequently, since SIC – 7 merely reiterates the requirements of IAS 21, it does give rise to any conflict either.

SIC – 8: First-Time Application of IASs as the Primary Basis of Accounting[1]

Summary

SIC – 8 deals with the following two issues:

(a) how the financial statements of an enterprise should be prepared and presented in the period when IASs are first applied in full as the primary accounting basis; and

(b) when IASs are first applied in full as the primary accounting basis, how specific transitional provisions set out in individual Standards and SIC Interpretations should be applied to balances of items that existed already at the effective date of those Standards and Interpretations.

SIC – 8 requires that in the period of first-time application of IASs as the primary basis of accounting, the financial statements of an enterprise (including comparative information) should be prepared and presented as if the financial statements had always been prepared in accordance with the IASs effective for the period of first-time application. An enterprise should apply the transitional provisions of the effective Standards and Interpretations only for periods ending on the date prescribed in the respective Standards and Interpretations. SIC – 8 also prescribes that certain disclosures be given in the period when IASs are applied in full for the first time.

Conclusion

Article 31(1)(b) of the Fourth Directive sets down the general principle that the methods of valuation must be applied consistently from one financial year to another. However, Article 31(2) permits companies to depart from this general principle in exceptional cases. In the view of the Contact Committee, the adoption of IAS would be an example of such exception circumstances. Nevertheless, Article 31(2) does require that such departure must be disclosed in the notes on the accounts and the reasons for them given together with an assessment of their effect on the assets, liabilities, financial position and profit or loss. Consequently, SIC – 8 does not give rise to any conflict with the Accounting Directives.

SIC – 9: Business Combinations – Classification either as Acquisitions or Uniting of Interests[1]

Summary

SIC – 9 provides clarification of the requirements in IAS 22 to be applied in determining whether a business combination should be classified as an acquisition or a uniting of interests. The Interpretation does not impose any new requirements, it merely reiterates and re-emphasises the guidance that is already contained in IAS 22, namely that a business combination should be accounted for as an acquisition unless an acquirer cannot be identified. This condition is already set down in paragraph 13 of IAS 22 (revised 1998), together with the additional guidance in IAS 22 that provides examples of important factors to be considered in determining whether the shareholders of one of the combining enterprises obtain control over the combined enterprise.

Conclusion

The Contact Committee has previously concluded that there exist no conflicts between IAS 22's requirements for the application of pooling accounting and the Accounting Directives. Article 20 of the Seventh Directive sets down certain minimum conditions that must be present in order to apply pooling, and these do not conflict with IAS 22. Consequently, since SIC – 9 merely provides further clarification of the requirements in IAS 22 to be applied in classifying a business combination, it is entirely consistent with the Directives.

SIC – 10: Government Assistance – No specific Relation to Operating Activities[1]

Summary

SIC – 10 deals with the situation where government assistance is given to enterprises under conditions that are not specifically related to the operating activities of the enterprise (for example, assistance may be given to an enterprise to run its business in an underdeveloped area). The issue is whether or not such assistance should be accounted for as a government grant under IAS 20. SIC – 10 states that government assistance does meet the definition of government grants under IAS 20, even if there are no conditions specifically relating to the operating activities of the enterprise other than the requirement to operate in certain regions or industry sectors.

Conclusion

The Contact Committee has previously concluded that there exist no conflicts between IAS 20 and the Accounting Directives. SIC – 10 merely provides further clarification of the definition of government grants contained in IAS 20, and therefore no new conflicts are introduced.

SIC – 11: Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations[1]

Summary

The Allowed Alternative Treatment in paragraph 21 of IAS 21 sets down several conditions that must be met before an enterprise can include exchange losses on foreign currency liabilities in the carrying amounts of the related assets. SIC – 11 provides an interpretation of what is meant by these conditions and how they should be applied in practice.

Conclusion

The Contact Committee has previously concluded that there exist no conflicts between IAS 21 and the Accounting Directives. SIC – 11 merely provides further interpretation of the conditions for the capitalisation of certain exchange differences contained in paragraph 21 of IAS 21, and therefore no new conflicts are introduced.

SIC – 12: Consolidation – Special Purpose Entities[2]

Summary

IAS 27 requires the consolidation of entities that are controlled by the reporting enterprise. However, the Standard does no provide explicit guidance on the consolidation of “Special Purpose Entities” (SPEs). An SPE is an entity that is created

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[2] Commission document DG MARKT 6905/01

usually to accomplish a narrow and well-defined objective, such as the securitisation of financial assets or the sale and leaseback of a non-financial fixed asset. An SPE may take the form of a company, trust, partnership or unincorporated entity, and is often created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers that its governing-board has over its operations.

SIC – 12 addresses the question of when a SPE would be consolidated by a reporting enterprise, and requires that an SPE should be consolidated when the substance of the relationship between an enterprise and the SPE indicates that the SPE is controlled by that enterprise

Analysis

The notion of including within the scope of the consolidation an entity that is controlled by the parent is entirely consistent with the conditions for the preparation of consolidated accounts as set out in Article 1(2) of the Seventh Directive, which states that Member States may require any parent undertaking governed by their national law to draw up consolidated accounts if it holds a participating interest in another undertaking (a subsidiary undertaking), and:

(a) it actually exercises a dominant influence over it; or

(b) it and the subsidiary undertaking are managed on a unified basis by the parent undertaking.

A "participating interest" is defined in Article 17 of the Fourth Directive as meaning rights in the capital of other undertakings.

Consequently, in situations where a parent undertaking both holds a participating interest in an SPE and controls it in the circumstances envisaged by SIC – 12, then it would be entirely consistent with the Seventh Directive for the SPE to be included in the scope of the parent undertaking's consolidation.

However, it is often the case that an enterprise's control over, and beneficial interests in, an SPE are established in a way that the enterprise does not own any of the SPE's equity. As a result, the enterprise would not hold a participating interest in the SPE and would therefore not meet one of the requirements in the Seventh Directive for inclusion of the SPE in the scope of the consolidation.

Conclusion

At the time that the Seventh Directive was adopted, the creation of SPEs in order to accomplish the commercial objectives that exist today was not envisaged. Nevertheless, this means that there exists a conflict between SIC – 12 and the Seventh Directive where a parent undertaking controls an SPE but does not have a participating interest in it. In such cases, the Directive would preclude the inclusion of the SPE within the scope of the consolidation.

The Contact Committee considered also whether the true and fair view override could be applied in order to overcome this conflict. However, the Committee noted that Article 16 of the Seventh Directive requires that consolidated accounts be drawn up in accordance with the Directive, and that the override can be applied only with respect to the assets, liabilities, financial position and profit or loss of the undertakings included therein. Thus, the Committee concluded that because the override cannot be applied to the scope of consolidation, the conflict between the Seventh Directive and SIC – 12 could not be resolved in this way.

However, the Contact Committee is of the view that the impact of this conflict may to some extent be ameliorated by the presentation of additional pro-forma disclosure information to show the effects of consolidating the SPE. The Committee also urged the Commission to deal with this issue as a matter of urgency under its programme of modernisation of the Accounting Directives.

SIC – 13: Jointly Controlled Entities – Non-Monetary Contributions by Venturers[1]

Summary

SIC – 13 provides an interpretation of paragraph 39 of IAS 31, clarifying the circumstances under which the appropriate portion of gains and losses resulting from a contribution of a non-monetary asset to a jointly controlled entity (JCE) in exchange for an equity interest in the JCE should be recognised by the venturer in the income statement.

Conclusion

The Contact Committee has previously concluded that there exist no conflicts between IAS 31 and the Accounting Directives. SIC – 13's further interpretation of paragraph 39 of IAS 31 does not change this position.

SIC – 14: Property, Plant and Equipment – Compensation for the Impairment or Loss of Items[1]

Summary

Enterprises may receive monetary or non-monetary compensation from third parties for the impairment or loss of items of property, plant and equipment. Often the monetary compensation received has to be used for compelling economic reasons to restore impaired assets or to purchase or construct new assets in order to replace the assets lost or given up. However, since IAS 16 does not give explicit guidance on how to account for such monetary or non-monetary compensation, the issue has been addressed in SIC – 14.

SIC – 14 confirms that three separate economic events are involved and that each event should be accounted for separately. The three separate events are:

(a) impairments or losses of items of property, plant and equipment;
(b) related compensation from third parties; and
(c) subsequent restoration, purchase or construction of assets.

SIC – 14 states that compensation is to included in the income statement when recognised. Recognising the compensation as deferred income or deducting it from the impairment or loss or from the cost of a new asset is not appropriate.

Conclusion

SIC – 14 is merely an application of the requirements embodied in IAS 36 and IAS 16 and does not create any conflict with the Accounting Directives.

SIC – 15: Operating Leases – Incentives[1]

Summary

In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with a pre-existing lease commitment of the lessee). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.
The issue that SIC – 15 addresses is how incentives in an operating lease should be recognised in the financial statements of both the lessee and the lessor. The Interpretation indicates that lease incentives (such as rent-free periods or contributions by the lessor to the lessee's relocation costs) should be considered an integral part of the consideration for the use of the leased asset. Consequently, SIC – 15 requires that: the lessor should recognise the aggregate cost of incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit of the leased asset is diminished; and the lessee should recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.

Conclusion

The Contact Committee has previously concluded that there exist no conflicts between IAS 17 and the Accounting Directives. SIC – 15's further interpretation of IAS 17 does not change this position.

SIC – 16: Share Capital-Reacquired Own Equity Instruments (Treasury Shares)[3]

Summary

SIC-16 refers to IAS 32, "Financial Instruments: Disclosure and Presentation". The two issues SIC-16 deals with are the following:

(1) how treasury shares should be presented in the issuing enterprise's balance sheet; and

(2) how the difference between the purchase cost and the consideration received should be presented when treasury shares are subsequently sold or issued.

On the aforementioned issues SIC-16 states that:

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[3] Commission document DG MARKT 6035/99

(1) Treasury shares should be presented in the balance sheet as a deduction from equity. The acquisition of treasury shares should be presented in the financial statements as a change in equity.

(2) On the sale, issuance or cancellation of treasury shares, consideration received should be presented in the financial statements as a change in equity. Therefore no gain or loss should be recognised in the income statement for the difference between the purchase cost and the re-sale price.

SIC-16 states that reductions to equity for treasury shares held should be disclosed separately either on the face of the balance sheet or in the notes. SIC-16 refers back to IAS 1.74(a)(vi) which states that the acquisition cost of treasury shares may be presented in the balance sheet or the notes in one of several ways, including for example:

– as a one-line adjustment to equity;

– the par value as a deduction from share capital, with adjustment of premiums or discounts against other categories of equity;

– each category of equity may be adjusted.

SIC-16 applies to instruments of the issuing enterprise that are classified as equity under IAS 32, and since they are not subject to IAS 32 it explicitly excludes from its scope two particular kinds of instruments:

(1) employers' obligations under employee stock option plans; and

(2) employers' obligations under employee stock purchase plans.

Consequently, the following paragraphs do not address the issue of how these instruments must be accounted for in accordance with the Accounting Directives.

Regime in the Second Directive

Article 18 of the Second Directive establishes a general prohibition for the acquisition of own shares. Article 19(1) allows Member States a general exception to this rule in so far as a number of conditions are fulfilled, including that the transaction may not have the effect of reducing net assets below the amount of subscribed capital and non-distributable reserves. Articles 19(2), 19(3) and 20 state, inter alia, additional specific exceptions that can be permitted by national law to the general prohibition stated in Article 18. Article 22(1)(b) requires that if the shares are included among the assets shown in the balance sheet, a reserve of the same amount, unavailable for distribution, shall be included in the liabilities. These capital maintenance provisions are aimed at protecting the interests of shareholders and creditors.

Regime in the Fourth Directive

To the extent that national law permits showing own shares in the balance sheet, Articles 8,9 and 10 of the Fourth directive provide for specific items in the balance sheet. Moreover, according to Article 13 own shares and shares in affiliated undertakings may be shown only under the items prescribed for that purpose. That is, fixed financial assets or current investments. Article 15(1) states that whether particular assets are to be shown as fixed assets or current assets shall depend upon the purpose for which they are intended. In addition, and consistently with Article 22(1)(b) of the Second Directive, Articles 8, 9 and 10 provide that a reserve of the same amount, unavailable for distribution, must be included in the liabilities side of the balance sheet.

Whilst the regime laid out in the Second Directive allows national law to permit the acquisition of own shares for certain purposes, it is not specified in the Fourth Directive in which cases national law may permit showing own shares on the balance sheet.

Similarly, if national law does not allow own shares to be shown on the balance sheet, there is no explicit guidance in the Accounting Directives as to how own shares acquired by the issuing enterprise should be accounted for.

Accounting treatments in national law

There seems to be general agreement that Articles 8, 9 and 10 of the Fourth Accounting Directive, together with Article 22 of the Second Directive, do not impose a single accounting treatment for accounting for own shares. This can be seen in practice when looking at the national accounting laws of the different Member States. A number of Member States have adopted treatments in their national law that account for own shares as a reduction in equity under certain circumstances. In fact a number of Member States have transposed the Fourth Directive into their national accounting laws on the basis that there can be different types of own shares' acquisitions and that the particular characteristics of each transaction make a particular accounting treatment more adequate than other. Member States can be classified, in this respect, as follows:

- Member States that allow the purchase of own shares primarily for share redemption purposes and present the purchase cost as a reduction to equity.
- Member States that allow the purchase of own shares for redemption and other purposes and present the purchase cost as a deduction from equity in all cases.
- Member States that allow the purchase of own shares for redemption and other purposes and which prescribe different accounting treatments depending upon the purpose for which the shares have been acquired. Some Member States when acquiring own shares for redemption purposes account for them as a deduction from equity, otherwise they must be accounted for as assets. Other Member States account for own shares as assets only when they have been acquired in the course of a market trading transaction, otherwise the shares will be accounted as a deduction from equity.

Therefore these different accounting treatments, rather than optional treatments equally applicable in all kind of situations, have been regarded as treatments to be used depending upon the nature of the transaction. However, the solutions adopted by the Member States in this respect are not the same.

Own shares as a deduction from equity

The Directives allow national laws to permit the acquisition of own shares. However if they do, the transaction cannot have the effect of reducing net assets below the amount of subscribed capital plus reserves unavailable for distribution.

The Contact Committee considered the question of whether own shares could be openly deducted from *paid-up capital* and it was of the opinion that such a treatment is not allowed by the Second and Fourth Directives.

With regard to the issue of whether or not own shares can be accounted for as a deduction from *equity*, most delegations in the Contact Committee and the Commission services hold the view that whilst it is not clear from the text of the Fourth Directive whether or not is allowed, it is not an objective of the Directives to eliminate this possibility. It is not necessarily inconsistent with the Fourth Directive. It can be argued that the Fourth Directive accepts this treatment if national law permits it and paid-up capital is not affected. In fact, this is the interpretation followed by a number of Member States whose national law requires such system in all or some types of purchases of own shares, which must not, in any case, affect the amount of paid-up capital.

SIC-16 does not necessarily impose an accounting treatment that may eventually contravene this requirement; rather it allows own shares to be presented as a deduction from equity in the notes as a one-line adjustment to equity. If the disclosures required by SIC-16 were to be given by way of note, this would not conflict with the requirements of the Directives. If the disclosures were given on the face of the balance sheet, it would not be in conformity with the Directives. It is not possible in accordance with Articles 8, 9, 10 and 13 of the Fourth Directive to present own shares on the face on the balance sheet other than as assets, either fixed assets or current assets.

A uniform accounting treatment for all transactions involving own shares: Further considerations

SIC-16 conclusion is nevertheless regarded by a number of Member States as a restrictive one, although not necessarily in conflict with the Directives. For some particular types of own shares acquisitions, a number of Member States consider that a conflict remains in practice, since the SIC-16 accounting treatment is not fully developed as it does not take into consideration the underlying substance of the transaction.

This conflict arises in the case of those acquisitions of own shares where the company intent is either to trade with the shares or to hold them, or the company trades on an index, with its own shares being a component of it. The scope of this situation varies among Member States since company law rules for eliminating the possibility of acquiring own shares with a trading and profit-making purpose are more restrictive in some Member States than in others.

Conclusion

It can be concluded that SIC-16 is compatible with the Accounting Directives for purchases intended for cancellation of own shares or some other types of purchases where the purpose is not to trade in the shares.

In some Member States where purchases for trading purposes are allowed and the shares are dealt with by the company like any other security, capitalisation is considered appropriate and consistent with the balance sheet layout requirements in the Fourth Directive. This is however not in conformity with SIC-16, and therefore a conflict with the national accounting law exists in a number of Member States. The application of SIC-16 in Member States whose accounting law requires, rather than permits, certain types of own shares acquisitions to be shown on the face of the balance sheet as assets will create a conflict. Furthermore, there is also a conflict with SIC-16 in such cases because the difference between the purchase cost and the resale price must be recognised in the profit and loss account, in accordance with the general valuation rules laid down in Article 31(1)(c).

SIC – 17: Equity - Costs of an Equity Transaction[4]

Summary

SIC – 17 deals with the costs incurred by an entity in issuing or acquiring its own instruments classified as equity when the transaction results in a net increase or decrease in equity.

Under this Interpretation, costs of an equity transaction are only those incremental external costs directly attributable to the equity transaction that would otherwise have been avoided. However, SIC – 17 does not apply to the costs of issuing an equity instrument that are directly attributable to the acquisition of a business.

The consensus reached on SIC – 17 is that the transaction costs of an equity transaction should be accounted for as a deduction from equity, net of any related income tax benefit. The costs of a transaction which fails to be completed should be expensed. Transaction costs that relate to the issuance of a compound instrument that contains both a liability and an equity element should be allocated to the component parts in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction, for example, costs of a concurrent offering of some shares and stock exchange listing of other shares, should be allocated to those transactions using a basis of allocation which is rational and consistent with similar transactions.

SIC – 17 requires further that the amount of transaction costs accounted for as a deduction from equity in the period should be disclosed separately.

Conclusion

Articles 9 and 10 of the 4th Directive start from the premise that share capital should be recorded in the balance sheet at the amount subscribed. Any unpaid amount should be shown as an asset (either as a separate item or as part of debtors), with the amount of any uncalled share capital shown separately.

However, a Member State may provide instead that share capital should be recorded at the amount called up, in which case only the amount of called-up share capital not paid is to be recorded as an asset (again, either as a separate item or as part of debtors).

In either case, any amount in excess of the nominal value (or, in the absence of a nominal value, accounting par value) of the shares should be credited to share premium account.

The issue of share issue costs is not specifically addressed in the Fourth Directive and, in particular, the requirement in SIC – 17 that the transaction costs of an equity

[4] Commission document DG MARKT 6906/01

transaction should be accounted for as a deduction from equity is not prohibited in (and therefore not inconsistent with) the Directives.

Nevertheless, the requirement in the 4th Directive for “Subscribed Capital” to be shown in the balance sheet would preclude the deduction of share issue costs from this amount. At the same time, though, this would not preclude an entity presenting subscribed capital gross and the share issue costs as either a negative figure or as a deduction from another reserve within equity. The approach chosen may well be governed by the specific company law requirements of the reporting entity, including those relating to the distribution of profits.

Some of the transaction costs that fall within the scope of SIC – 17 may well fall to be formation expenses as defined by national law. The balance sheet formats set out in Articles 9 and 10 of the 4th Directive show “formation expenses” as a separate caption under the assets section (National law may also permit formation expenses to be included with intangible assets). Article 34(1)(a) requires further that “where national law authorises the inclusion of formation expenses under ‘Assets’, they must be written off within a maximum period of five years”. The profit and loss account formats set out in Articles 23 to 26 of the 4th Directive provide a caption for such write-offs.

Overall, therefore, the Contact Committee has concluded that SIC – 17 does not conflict with the European Accounting Directives.

SIC – 18: Consistency – Alternative Methods[4]

Summary

The issue considered in the interpretation is how the choice of accounting policy should be exercised in the context of those IAS that allow an explicit choice of accounting policy but are silent on the manner of exercising that choice. The fundamental question is whether, once a choice of policy is made, that policy should be followed consistently for all items accounted for under the specific requirements that provide the choice.

The consensus reached by the SIC is that if more than one accounting policy is available under an International Accounting Standard or Interpretation, an enterprise should choose and apply consistently one of those policies, unless the Standard or Interpretation specifically requires or permits categorisation of items (transactions, events, balances, amounts, etc.) for which different policies may be appropriate. If a Standard requires or permits categorisation of items, the most appropriate accounting policy should be selected and applied consistently to each category. Once the appropriate initial policy has been selected, a change in accounting policy should only be made in accordance with IAS 8 and applied to all items or categories of items.

Conclusion

Article 31(1)(b) requires that the methods of valuation must be applied consistently from one financial year to another. Consequently, the requirements of SIC – 18 are entirely consistent with the consistency concept that is embodied in the Fourth Directive.

SIC – 19: Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29[5]

Summary

Paragraph 4 of IAS 21 states that while that Standard does not specify the currency in which an enterprise presents its financial statements, an enterprise normally uses the currency of the country in which it is domiciled. While IAS 21 defines the term “reporting currency” as the currency used in presenting the financial statements, the reporting currency used by an enterprise also has significant implications for accounting measurement in the financial statements.
The issues considered by SIC were:

(a) how an enterprise determines a currency for measuring items in its financial statements (the “measurement currency”);

(b) whether an enterprise may use a currency other than the measurement currency for presenting its financial statements (the “presentation currency”); and

(c) if the presentation currency may be different from the measurement currency, then how the financial statements should be translated from the measurement currency to the presentation currency.

The SIC agreed that a measurement currency should provide information about the enterprise that is useful and reflects the economic substance of the underlying events and circumstances relevant to that enterprise. If a particular currency is used to a significant extent in, or has a significant impact on, the enterprise, that currency may be an appropriate measurement currency. All transactions in currencies other than the measurement currency should be treated as transactions in foreign currencies when applying IAS 21. Once an enterprise has selected a measurement currency, the SIC agreed that it should not be changed unless there is a change in the underlying events and circumstances relevant to that enterprise.

Although an enterprise normally presents its financial statements in the same currency as the measurement currency, the SIC also agreed that it may choose to present its financial statements in a different currency. Although not addressed specifically by SIC – 19, it does state that the method of translating the financial statements of a reporting enterprise from the measurement currency to a different currency for presentation should not lead to reporting in a manner that is inconsistent with the measurement of items in the financial statements.

Conclusion

The issue of how an entity determines its measurement and presentation currencies is not addressed directly in the Directives.
Consequently, the Contact Committee has concluded that SIC – 19 does not conflict with the European Accounting Directives.

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[5] Commission document DG MARKT 6907/01

SIC – 20: Equity Accounting Method – Costs of an Equity Transaction[5]

Summary

SIC – 20 addresses the application of the equity method of accounting for an associate when the investor's share of losses equals or exceeds the carrying amount of the investment. The SIC concluded that if the investor's share of losses exceeds the carrying amount of the investment, the carrying amount of the investment is reduced to nil and recognition of further losses should be discontinued, unless the investor has incurred obligations to the investee or to satisfy obligations of the investee that the investor has guaranteed or otherwise committed. The SIC concluded that, for the purpose of applying this approach, the carrying amount of the investment in an associate should include common shares and preferred shares that provide unlimited rights of participation in earnings or losses and a residual equity interest in the associate.

Conclusion

Article 59 of the Fourth Directive and Article 33 of the Seventh Directive permit the valuation of holdings in affiliated undertakings by the equity method provided certain conditions are fulfilled. Amongst these is the requirement that the purchase price of these holdings shall be increased or reduced in the balance sheet by the profits or losses realized by the affiliated undertaking according to the percentage of capital held by the investor. However, the Directive does not specify in further detail the application of this principle to the specific situation dealt with in SIC – 20.
Consequently, the Contact Committee has concluded that SIC – 20 does not conflict with the European Accounting Directives.

SIC – 21: Income Taxes – Recovery of Revalued Non-Depreciable Assets[5]

Summary

SIC – 21 confirms that the deferred tax liability or asset that arises from the revaluation of a non-depreciable asset under IAS 16 is measured based on the tax consequences that would follow from recovery of the carrying amount of that asset through sale. Because the asset is not depreciated, no part of its carrying amount is considered to be recovered (i.e. consumed) through use.

Conclusion

This issue of the measurement of deferred tax assets and liabilities that arises on the revaluation of non-depreciable assets is not addressed directly by the Directives. The Contact Committee notes further that it has concluded already that IAS 12 is compatible with European Accounting legislation to the extent that the following conditions are fulfilled:

- The recognition of deferred tax assets is subject to a prudent assessment. A conflict with the Accounting Directives could arise when deferred tax assets are recognised in situations where reasonable doubts exist that taxable profit will be available against which the deductible temporary differences can be utilised.
- The recognition of deferred tax liabilities is subject to a probability test. A conflict with the Accounting Directives could arise when deferred tax liabilities or provisions for taxation are recognised for taxable temporary differences for which it is not likely that a future liability will arise.
- The presentation of deferred tax assets and liabilities is made in accordance with the Formats prescribed by the Accounting Directives. IAS 1 makes provision for companies to avoid having to use the current/non-current classification in respect of balance sheet assets and liabilities. Consequently, companies that apply the Accounting Directives would be required to take advantage of this provision, with the result that paragraph 70 of IAS 12 would not apply, thereby enabling them to disclose deferred tax assets in line with the Directive.

Consequently, the Contact Committee has concluded that SIC – 21 does not alter its previous assessment of the conformity between IAS 12 and the Directives.

SIC – 22: Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported[5]

Summary

SIC – 22 addresses adjustments to identifiable assets and liabilities and goodwill, which are made to recognise identifiable assets and liabilities that previously did not satisfy recognition criteria, and adjustments made to reflect additional evidence of the amounts initially assigned in accounting for an acquisition under the purchase method. Such adjustments should be calculated as if the newly assigned values had been used from the date of acquisition. SIC – 22 clarifies also that adjustments to amounts included in the income statement, such as depreciation or amortisation of goodwill, are included in the corresponding category of income or expense presented on the face of the income statement.

Conclusion

The Contact Committee has examined IAS 22 (Revised 1998) in the context of the European Accounting Directives in order to consider whether, and to what extent, to apply IAS 22 in European jurisdictions. The Contact Committee notes that SIC – 22 does not deal with an issue that is addressed specifically by the Directives.

Consequently, the Contact Committee has concluded that SIC – 22 does not conflict with the European Accounting Directives.

SIC – 23: Property, Plant and Equipment – Major Inspection or Overhaul Costs[5]

Summary

SIC – 23 addresses the question of whether the cost of major inspections or overhauls of an item of property, plant and equipment should be capitalised as a component of the asset or expensed.

The SIC concluded that the costs of a major inspection or overhaul incurred subsequent to the acquisition of the asset are generally expenses. However, such costs are capitalised when the enterprise has identified as a separate component of the asset an amount representing major inspection or overhaul and has already depreciated that component to reflect the consumption of benefits that are replaced or restored by the subsequent major inspection or overhaul. The criteria for recognition of an asset under IAS 16 must be met also.

Conclusion

Major inspection and overhaul costs that are capitalised under SIC – 23 as a separately identified component of an asset fall within the definition of a fixed asset under Article 15(2) of the Fourth Directive. Article 35(1)(a) of the Fourth Directive states that fixed assets must be valued at purchase price or production cost. Consequently, the Contact Committee considers that it is clear that, in the circumstances described in SIC - 23, it is appropriate to include costs of a major inspection or overhaul incurred subsequent to the acquisition of the asset within the cost of that asset.

Consequently, the Contact Committee has concluded that SIC – 23 does not conflict with the European Accounting Directives.

SIC – 24: Earnings Per Share – Financial instruments and other contracts that may be settled in shares[5]

Summary

SIC – 24 addresses the treatment of instruments, which may be settled by a reporting enterprise either by payment of financial assets or by issuance of ordinary shares of the reporting enterprise to the holder. The SIC agreed that all instruments that may result in the issuance of ordinary shares of the reporting enterprise to the holder of the financial instrument or other contract, at the option of the issuer or the holder, are potential ordinary shares of that enterprise. If a potential ordinary share is dilutive, (that is, its conversion to ordinary shares would decrease net profit per share from continuing ordinary operations) then its dilutive effect is included in calculating diluted earnings per share.

Conclusion

The issues of the calculation of earnings per share and diluted earnings per share are not addressed by the Directives.
Consequently, the Contact Committee has concluded that SIC – 24 does not conflict with the European Accounting Directives.

SIC – 25: Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders[5]

Summary

A change in the tax status of an enterprise or of its shareholders may have consequences for an enterprise by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an enterprise's equity instruments or upon the restructuring of an enterprise's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an enterprise may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future. A change in the tax status of an enterprise or its shareholders may have an immediate effect on the enterprise's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the enterprise, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the enterprise's assets and liabilities.
The issue addressed by SIC – 25 is how an enterprise should account for the tax consequences of a change in its tax status or that of its shareholders.
The SIC concluded that a change in the tax status of an enterprise or its shareholders does not give rise to increases or decreases in amounts recognised directly in equity. The current and deferred tax consequences of a change in tax status should be included in net profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in net profit or loss) should be charged or credited directly to equity. An example of an event that is recognised directly in equity is a change in the carrying amount of property, plant or equipment revalued under IAS 16.

Conclusion

SIC – 25 addresses a very specific issue that is not addressed directly in the Directives.

Consequently, the Contact Committee has concluded that SIC – 25 does not conflict with the European Accounting Directives.