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**International
Accounting Standards
Board**

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: September 2006, London

**Project: Classification of and accounting for SIM cards
(Agenda Paper 8(iii))**

INTRODUCTION

1. In May 2006, the IFRIC received a request for an Interpretation of how a Subscriber Identity Module (or 'SIM card') should be accounted for by a mobile phone operator.
2. The submission stated that a mobile phone operator recognises SIM cards held for sale in the ordinary course of business, as intangible assets in progress at the time of acquisition, and intangible assets at the time of activation. Both categories are classified within non current assets. After activation, the SIM cards are amortised over a 2 year life (the life of the customer contract).
3. The submission noted that :
 - SIM cards are essential to triggering a mobile phone service subscription which generates future economic benefits.
 - The cost of SIM cards can be measured reliably.

- SIM cards are separable.
 - The mobile phone operator keeps ownership of SIM cards for the minimum subscription period of 2 years.
4. The question which was raised was whether SIM cards fall within the scope of IAS 2 *Inventories* and so should be accounted for as inventory from the point of initial acquisition.

DEFINITIONS

5. IAS 2.6 defines inventories as “assets:
- held for sale in the ordinary course of business;
 - in the process of production for such sale; or
 - in the form of materials or supplies to be consumed in the production process or in the rendering of services.”
6. IAS 38.8 defines an intangible asset as “an identifiable non-monetary asset without physical substance.”
7. IAS 1.57 states that “an asset shall be classified as current when it satisfies any of the following criteria :
- It is expected to be realised in, or is intended for sale or consumption in, the entity’s normal operating cycle;
 - It is held for the primary purpose of being traded;
 - It is expected to be realised within 12 months of the balance sheet date;
- or
- It is cash or cash equivalent ...

All other assets shall be classified as non-current.”

STAFF ANALYSIS

Introduction

8. The staff considers that the classification of a SIM card may differ before and after activation. The staff have therefore considered each of these scenarios separately.

SIM cards held by an operator prior to activation

9. A SIM card can be seen as being held for sale in the ordinary course of business (many mobile operators sell SIM cards as a separate item), as being held in the process for production (if they are seen as an integral part of a mobile phone which will not work without such a card), or as something which is consumed in the rendering of a service.
10. The staff therefore considers that a SIM card meets the definition of inventory in IAS 2.
11. Since SIM cards held by an operator prior to activation are intended for consumption in the entity's normal operating cycle, the staff believes that, in accordance with IAS 1.57, the inventory of SIM cards should be classified as current assets.

Accounting for the SIM card after activation

12. The staff considers that once a SIM card is activated and allocated to a customer, it ceases to meet the definition of inventory and should be derecognised as inventory.
13. The staff notes that the IFRIC has previously considered how a mobile phone operator should account for telephone handsets which an operator provides free, or at a reduced price to a customer, and that it declined to take the issue onto its agenda.
14. The staff considers that there is no difference between a SIM card which is provided to a customer free, or at a reduced price and a mobile phone which is provided free or at a reduced price and so the accounting for the two should be similar.
15. Attachment 1 to this document shows the Agenda Decision published in the March 2006 IFRIC Update in respect of mobile telephones provided free or at a reduced price to customers.

Consideration of whether the issue should be taken onto the IFRIC agenda

Existence of significantly divergent interpretations

16. The staff is aware of some diversity in practice both in the classification of SIM cards prior to activation and in the treatment of SIM card and mobile phone sales after activation.

Practical and widespread relevance

17. Prior to activation, the issue only relates to SIM cards which typically comprise a very small percentage of the total cost of services provided to customers by mobile phone operators. The issue submitted to the IFRIC only relates to the classification of these costs on the balance sheet and is therefore unlikely to have practical and widespread relevance.
18. As discussed above, the IFRIC has previously considered the treatment of mobile phones after activation and allocation to a customer and the wording of its decision is set out in Attachment 1 to this paper. Its published decision concludes that “the question is of widespread relevance, both across the telecommunications industry and, more generally”.

Relation to a Board project

19. The issue is unlikely to be resolved by any of the Board’s current projects.

Timeliness of a consensus view of the IFRIC

20. On the issue how SIM cards should be classified prior to activation, there is no reason why the IFRIC should not reach a consensus. .
21. The issue how SIM cards should be classified after activation is closely related to the treatment of subscriber acquisition costs in the mobile phone industry. As discussed above, the IFRIC has already declined to take that issue onto its agenda for the reason that it would not be able to reach a consensus on a timely basis.

Conclusion

22. The staff considers that there is divergence in practice.
23. Prior to activation, this divergence is only around the classification of SIM cards on the balance sheet. The staff considers that the guidance in this area is clear and the issue should not be taken onto the agenda.
24. After activation, in line with the IFRIC’s decision at its March 2006 meeting, the staff considers that the IFRIC is unlikely to reach a consensus on the issue. The staff therefore considers that the issue should not be taken onto the IFRIC agenda.
25. [Paragraph omitted from observer note, together with draft text for Tentative Agenda Decision].

Attachment 1: Extract from March 2006 Agenda Decisions

Issue:

“Subscriber Acquisition Costs in the Telecommunications Industry

The IFRIC considered how a provider of telecommunications services should account for telephone handsets it provides free of charge or at a reduced price to customers who subscribe to service contracts. The question was whether:

- the contracts should be treated as comprising two separately identifiable components, i.e. the sale of a telephone and the rendering of telecommunication services, as discussed in paragraph 13 of IAS 18 *Revenue*. Revenue would be attributed to each component; or
- the telephones should be treated as a cost of acquiring the new customer, with no revenue being attributed to them.”

Reason for not adding to the IFRIC agenda

“The IFRIC acknowledged that the question is of widespread relevance, both across the telecommunications industry and, more generally, in other sectors. IAS 18 does not give guidance on what it means by ‘separately identifiable components’ and practices diverge.

However, the IFRIC noted that the terms of subscriber contracts vary widely. Any guidance on accounting for discounted handsets would need to be principles-based to accommodate the diverse range of contract terms that arise in practice. The IASB is at present developing principles for identifying separable components within revenue contracts. In these circumstances, the IFRIC does not believe it could reach a consensus on a timely basis. The IFRIC, therefore, decided not to take the topic onto its agenda.”