Update on the activity of the IFRS Interpretations Committee

Objective

1 The objective of this paper is to provide for information purposes a summary of the main issues discussed by the IFRS Interpretations Committee (the 'IFRS IC').

2 The paper focuses on the issues that are still 'open' at the date of the summary that is matters that have not yet led to final decision by the IFRS IC.

3 The purpose of the presentation is to raise EFRAG TEG's awareness on the issues being discussed at the IFRS IC and possible interactions with EFRAG's commenting activities and future standard setting. The session is not intended, however, to respond to the IFRS IC tentative decisions. Therefore, the paper does not contain EFRAG Secretariat's initial views on the issues and does not seek EFRAG TEG's technical assessment on the matters.

4 If EFRAG TEG expresses the wish to further discuss any of the presented issues a session could be organised at a future meeting.

Overview of IFRS IC's current activity

Projects (include hyperlinks to the IASB project pages for each item)	Related Standards	Current status	Next milestone	Expected date
Tentative agenda decisions (ongoing consultations)				
Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition	**IAS 32**	**Consultation on tentative AD until 24 May**	**Consider feedback to tentative AD**	**Q3 2021**
Costs Necessary to Sell Inventories	IAS 2	Consultation on tentative AD until 21 October	Consider feedback to tentative AD	Jun-21
Non-refundable Value Added Tax on Lease Payments	IFRS 16	Consultation on tentative AD until 24 May	Consider feedback to Tentative AD	Q3 2021
Preparation of Financial Statements when an Entity is No Longer a Going Concern	IAS 10	Consultation ended on 14 April	Consider feedback to Tentative Agenda Decision	Jun-21

Projects	Related Standards	Current status	Next milestone	Expected date
Finalised AD subject to IASB approval				
Attributing Benefit to Periods of Service	**IAS 19**	**Consultation ended 15 Feb**	**Agenda Decision**	**May-21**
Hedging Variability in Cash Flows due to Real Interest Rates	IFRS 9	Consultation ended 15 Feb	Agenda Decision	May-21
Agenda decision not finalised – IASB to decide on project direction				
Classification of Debt with Covenants as Current or Non-current	**IAS 1**	**Feedback to tentative AD considered at April meeting**	**IASB to decide on project direction**	**Jun-21**
Sale and Leaseback of an Asset in a Single-Asset Entity	IFRS 16 and IFRS 10	Recommend standard setting (Feb 2021)	IASB to decide project direction	Not specified
Items for future consideration				
Power purchase agreements in a gross pool electricity market	**IFRS 16**			**Not specified**
ECB - Third targeted longer-term refinancing operations programme	IFRS 9 and IAS 20			Not specified

Tentative agenda decisions (ongoing consultations)

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition

What is the issue?

5 In the fact pattern a warrant provides the holder with the right to buy a fixed number of equity instruments (of the issuer) for an exercise price that will be fixed at a future date.

6 Applying IAS 32.16 at initial recognition, the variability in the exercise price results in the issuer classifying these instruments as financial liabilities. That is, it does not meet the fixed-for-fixed condition. This request asked whether it is possible for the issuer to reclassify a warrant as an equity instrument following the fixing of its exercise price after initial recognition –given that the fixed-for-fixed condition would be met at that stage.

IFRS IC tentative conclusions

7 The IFRS IC has tentatively observed that:

(a) IAS 32 has no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged. Similar questions about reclassifications arise in other circumstances.

(b) Reclassification by the issuer was one of the practice issues the IASB will consider in its Financial Instruments with Characteristics of Equity (FICE) project.

(c) This specific issue raised is, in isolation, too narrow to address in a cost-effective manner.

8 The IASB should consider the matter as part of its discussions on the FICE project.

Costs Necessary to Sell Inventories (IAS 2)

What is the issue?

9 The issues addressed what costs to consider as the 'estimated costs necessary to make a sale' when determining the net realisable value of inventories; more particularly whether an entity includes all costs necessary to make the sale or only those that are incremental to the sale of inventory.

10 Paragraph 5 of IAS 2 defines net realisable value as 'the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make a sale'. IAS 2.28 describes the net realisable value objective is to avoid inventories being carried in excess of amounts expected to be realised for their sale.

11 Costs of disposal is generally defined by IFRS Standards to include 'incremental costs directly attributable to the disposal of an asset'. The terminology used in IAS 2 is not 'costs of disposal' so it is not clear whether analogising to this principle is appropriate.

IFRS IC tentative conclusions

12 The IFRS IC has concluded that that when determining net realisable value of inventories, IAS 2 requires an entity to estimate the costs necessary to make the sale. The requirements do not allow an entity to restrict such costs to only those that are incremental.

13 Further, entities engage in selling activities in their ordinary course of business and the costs of such activities are not always incremental to the sale of particular items of inventory. An entity will need to use its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of inventories.

Non-refundable Value Added Tax on Lease Payments (IFRS 16)

What is the issue?

14 The submission received addresses how to account for non-refundable value-added tax (VAT) charged on lease payment: does a lessee include non-refundable VAT as part of the lease payments for a lease under IFRS 16 Leases?

15 In the fact pattern present local VAT legislation requires sellers to collect VAT and remit amounts to the government. In addition, purchasers are generally allowed to recover from the government VAT charged on payments for goods or services, including leases. Because of the nature of the lessee's operations the entity is unable to recover all of the VAT charged on payments it makes for leases.

IFRS IC tentative conclusions

16 The IASB staff conducted limited outreach that indicated that almost all respondents did not include non-refundable VAT as part of the lease payments (as they are not payments to the lessor in exchange for the right to use the underlying asset) and that non-refundable VAT on lease payments is generally not material.

17 The IFRS IC has tentatively observed that there is no evidence of diversity in the way lessees account for non-refundable VAT on lease payments.

18 The IFRS IC has tentatively concluded that it has not yet obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected.

Preparation of Financial Statements when an Entity is No Longer a Going Concern

What is the issue

19 The IFRS IC received a submission about the accounting applied by an entity that ceases to be a going concern after the end of the reporting period but before the accounts are approved for issue. The submitter included two variations of a fact pattern:

(a) Scenario 1: Financial statements for the last three years (2017 to 2019) have not been finalised. At each of the three-year ends management concluded that the entity would continue as a going concern. It is now eight months after the most recent year end and management have decided to voluntarily liquidate the entity.

(b) Scenario 2: Financial statements for the most recent reporting date have yet to be finalised. All prior year financial statements have been finalised. It is now eight months after the most recent year end and management have decided to voluntarily liquidate the entity.

IFRS IC tentative conclusions

20 The IFRIS IC has tentatively observed the following for each of the above scenarios:

First scenario

(a) The principles and requirements in IAS 10 provide an adequate basis for an entity that is no longer a going concern to determine whether it prepares its financial statements on a going concern basis.

(b) In the fact pattern described, the 2017, 2018 and 2019 financial statements are all authorised for issue after the decision to liquidate the entity –which is an adjusting event after reporting date.

(c) An entity that is no longer a going concern cannot prepare financial statements (i.e., for all three years) on a going concern basis.

First scenario

(a) The IFRS IC observed that its research showed that there was no diversity in application of IFRS Standards to this scenario –i.e., entities do not restate comparatives.

(b) Therefore, IFRIS IC will not comment further on this scenario.

21 Finalised AD subject to IASB approval or re-consideration

Attributing Benefit to Periods of Service (IAS 19)

What is the issue?

22 An entity has a defined benefit plan whereby employees are entitled to a retirement benefit when they reach age 62 and are still employed by the entity at that date. Such plans exist in France and Greece for instance. The amount is calculated as one month salary for each year of service, capped at 16 months of final salary. That is, their retirement benefit is calculated using only the number of consecutive years of employee service immediately before retirement (at age 62).

23 The question is over what period of service should an entity attribute the benefit (i.e., the whole period of service, only the 16 last years…)?

IFRS IC conclusions

24 The IFRS IC has considered that IAS 19.73 requires that an entity's obligation increases until the date when future service by the employee will lead to no material amounts of further benefits. As such each year of service between age 46 and age

62 leads to further benefits. After age 62 no further benefit accrues. Prior to age 46 no benefit accrues.

25 As such the entity attributes the retirement benefit to each year in which the employee renders service from the age of 46 to the age of 62. The conclusion also aligns with the first part of Example 2 illustrating IAS 19.73.

Hedging Variability in Cash Flows due to Real Interest Rates (IFRS 9)

What is the issue?

26 The issue at stake is whether a non-contractually specified real interest rate risk component can be designated as the hedged item in a cash flow hedging relationship?

27 In the fact pattern presented an entity hedges a floating rate debt referenced to LIBOR with an inflation swap, which swaps the variable interest cash flows of the floating rate debt for variable cash flows based on an inflation index.

(a) The risk management objective is to 'fix' the cash flows in real terms.

(b) The entity applies the hedging requirements of IFRS 9 Financial Instruments, i.e., not IAS 39.

IFRS IC conclusions

28 The IFRS IC has concluded that there is no exposure to variability in cash flows that is attributable to changes in the real interest rate in the proposed cash flow hedging relationship and, thus, the requirements in IFRS 9.6.3.7 and IFRS 9.6.5.2(b) of IFRS 9 are not met.

29 Consequently, the real interest rate risk component in the proposed cash flow hedging relationship does not meet the requirements to be designated as an eligible hedged item as required by IFRS 9.6.4.1.

Agenda decision not finalised – IASB to decide on project direction

Classification of Debt with Covenants as Current or Non-current (IAS 1) – discussed in TEG 19 January and 3 March

What is the issue?

30 In January 2020, the IASB issued Classification of Liabilities as Current or Non-current, which amended IAS 1 and clarified how to classify debt and other financial liabilities as current or non-current in particular circumstances.

31 In response to feedback and enquiries from some stakeholders, the IFRS IC discussed how an entity applies the IAS 1 amendments to particular fact patterns, when the right to defer settlement is subject to the entity complying with specified conditions; that are tested after the end of the reporting period.

32 The IFRS IC more particularly discussed three fact patterns with a 5-year loan that requires an entity to maintain a particular working capital ratio.

Case 1

- The loan includes a covenant that requires a working capital ratio above 1.0 at each 31 December, 31 March, 30 June and 30 September. The loan becomes repayable on demand if this ratio is not met at any of these testing dates.
- The entity's working capital ratio on 31 December 20X1 is 0.9 but the entity obtains a 3-month waiver before the reporting date with respect to the breach at that date. The entity expects the working capital ratio to be above 1.0 on 31 March 20X2 (and the other testing dates in 20X2).

Case 2

- The covenant requires a working capital ratio above 1.0 at each 31 March (i.e., the ratio is tested only once a year on 31 March). The loan becomes repayable on demand if the ratio is not met at any testing date.
- The entity's working capital ratio on 31 December 20X1 is 0.9. The entity expects the working capital ratio to be above 1.0 on 31 March 20X2.

Case 3

- Instead of the condition described in Case 1, the covenant requires a working capital ratio above 1.0 on 31 December 20X1 and above 1.1 on 30 June 20X2 (and at each 30 June thereafter). The loan becomes repayable on demand if the ratio is not met at any of these testing dates.
- The entity's working capital ratio on 31 December 20X1 is 1.05. The entity expects the working capital ratio to be above 1.1 on 30 June 20X2.

IFRS IC conclusions

33 The IFRS IC published a tentative agenda decision in December 2020 that concluded that, for all three fact patterns described, the entity is required to classify the loan as current because the entity does not have the right at the end of the reporting period (31 December 20X1) to defer settlement of the loan for at least twelve months after the reporting period.

34 In reaching its conclusion, the IFRS IC noted that the entity's expectation that it will meet the condition tested after the reporting period does not affect its assessment of the criterion in paragraph 69(d) of IAS 1.

35 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for the entity to determine how to classify the loan as current or non-current in the three fact patterns described in the agenda decision. Consequently, it decided not to add a standard-setting project to the work plan.

36 At its April 2021 meeting the IFRS IC considered the feedback received in response to its tentative agenda consultation published in December 2020. The feedback generally confirmed support for the technical analysis although concerns were raised about the outcome by many respondents.

37 The IFRS IC confirmed its agreement with the technical analysis and conclusions in the tentative agenda decision. Nonetheless, before finalising the agenda decision, it decided to report to the IASB to decide on the project direction.

Previous TEG discussion/Status of the Endorsement

38 EFRAG has issued a draft endorsement advice relating to the endorsement for use in the European Union (EU) of 'Classification of Liabilities as Current or Non-current' and 'Deferral of Effective Date' on 6 November 2020. EFRAG TEG was considering in January 2021 the IFRS IC discussion and the impact on the endorsement advice and decided to postpone the final decision about the endorsement advice until the IFRS IC discussion is finalised. In the meeting 3 March 2021 EFRAG TEG was informed about the responses from European constituents to the IFRS IC consultation.

Sale and Leaseback of an Asset in a Single-Asset Entity (IFRS 10 and IFRS 16)

What is the issue?

39 In the fact pattern presented an entity (seller –lessee) enters into a sale and leaseback transaction. The following is assumed:

(a) the seller sells all of its equity interest in a subsidiary to a third party and as a consequence loses control of that subsidiary –the subsidiary holds only one asset (building) and has no liabilities,

(b) the seller enters into a contract to lease the building held by the (ex)subsidiary back for a period,

(c) the sale satisfied the requirements under IFRS 15 Revenue from Contracts with Customers,

(d) the sale price equals the fair value of the building and exceeds its carrying amount.

40 The question is whether the seller-lessee, in its consolidated financial statements, recognises only the amount of the gain that relates to the rights transferred to the third party (applying the principles in IFRS 16 for sale and leaseback transactions)?

IFRS IC conclusions

41 The IFRS IC tentatively observed that the entity:

(a) First applies IFRS 10 Consolidated Financial Statements paragraph 25 and B97 -B99 to derecognise the building held by the subsidiary and recognise the fair value of the consideration received.

(b) Then, if the transfer satisfies the requirements in IFRS 15 to be accounted for as a sale, the entity applies paragraph 100(a) of IFRS 16 Leases to measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the building that relates to the right of use it retains. In addition, it recognises only the amount of any gain that relates to the rights transferred to the buyer-lessor.

42 It was noted that the fact pattern is very narrow, with the subsidiary only holding one asset and has no liabilities. IFRS IC members were concerned about issues that might arise in more complex fact patterns –for example, sells a business and lease back only one asset.

43 The IFRS IC decided to recommend the matter to the IASB for possible standard setting.

Items for future consideration

ECB -Third targeted longer-term refinancing operations programme

44 The IFRIC IC received a request from the European Securities and Markets Authority on the accounting for the European Central Bank's (ECB) provision of financing to credit institutions under the ECB's third targeted longer-term refinancing operations (TLTROs) programme. The paper is still at the preliminary research stage; however, the issue is likely to be further discussed at a future meeting.

45 The amount that banks can borrow under the TLTRO programme is linked to their loans to non-financial corporations and households. By offering banks long-term funding at attractive conditions they stimulate bank lending to the real economy. Upon meeting certain lending performance thresholds bank can receive loan at reduced interest rates. Also, during 2020, some of the transaction parameters were modified due to disruptions and temporary funding shortages associated with the COVID-19 pandemic.

46 ESMA observes a diversity in practice regarding the accounting for a variety of issues that accompany such a transaction (i.e. accounting for below market interest rates using IFRS 9 or IAS 20) and invites the IFRS IC to clarify the applicable requirements.

Power purchase agreements in a gross pool electricity market

47 IFRIC received a request as to whether a power purchase agreement (PPA) in a gross pool electricity market is, or contains, a lease as defined in IFRS 16 Leases. The paper is still at the preliminary research stage; however, the issue is likely to be further discussed at a future meeting.

48 A gross pool electricity market clears all purchases and sales of electricity through a market operator – that acts as a clearing house - on a gross basis. There is no bilateral contractual arrangement between an actual seller (generator) and an actual buyer (retailer). The market operator determines the spot price, clearing price that matches supply with demand, for interval during the trading day.

49 In a gross pool electricity market, generators and retailers that elect to manage their exposure to spot price risk do so by entering into arrangements which are settled outside the spot market (e.g. swaps, PPAs etc.). In the specific submission a fact pattern, where – amongst other specifics - the retailer participated in the design of a windfarm that is constructed and operated by the energy generator (under a PPA). Under the PPA the spot price for the amount of energy per interval is swapped into a fixed price as both parties agree to a net settlement (energy spot price vs. price fixed in the PPA).

50 The submitter invites the IFRS IC to clarify whether the retailer obtains substantially all the economic benefits from the use of the asset (windfarm) as part of the assessment under IFRS 16. This transaction is widespread in the utilities sector, but also gets increasingly important in other sectors, as under the PPA in almost all cases the renewable energy credits will be transferred to the client.