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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 open 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 a final decision by the IFRS IC.

3 The purpose of the presentation is to raise EFRAG FR TEG's and EFRAG FR CFSS'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 FR TEG's nor EFRAG FR CFSS's technical assessment on the matters.

4 If EFRAG FR TEG or EFRAG FR CFSS express 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

5 Below is an overview of the IFRS IC's current activities.

Project **(including hyperlinks to the IASB project pages for each item)**	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
Ongoing consultations regarding tentative agenda decisions				
Negative low emission vehicle credits	IAS 37	Consultation ending 12 April 2022	Tentative Agenda Decision Feedback	Q2 2022
Tentative Agenda Decision Feedback				
Cash received via an electronic transfer system	IFRS 9	Consultation ended 25 Nov 2021	Tentative Agenda Decision Feedback	Q2 2022
Demand deposit with restrictions on use	IAS 7	Consultation ended 25 Nov	Tentative Agenda Decision Feedback	March 2022

Project (including hyperlinks to the IASB project pages for each item)	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
Principal versus agent: Software resellers	IFRS 15	Consultation ended 8 February 2022	Tentative Agenda Decision Feedback	April 2022
Finalised AD subject to IASB approval				
TLTRO III Transactions	IAS 20, IFRS 9	Finalised February 2022	Agenda decision	March 2022 IASB meeting
Initial consideration				
Profit Recognition for Annuity Contracts	IFRS 17	Initial consideration	Decide project direction	March 2022
Rent Concessions: Lessors and Lessees	IFRS 16 IFRS 9	Initial consideration	Decide project direction	March 2022
Special Purpose Acquisition Companies (SPAC): Classification of Public Shares as Financial Liabilities or Equity	IAS 32	Initial consideration	Decide project direction	March 2022
Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition	IAS 32	Initial consideration	Decide project direction	March 2022
Items for future consideration				
Valuation of lease payments based on the cadastral value	IFRS 16			Not specified

Ongoing consultations regarding tentative agenda decisions

Negative low emission vehicle credits

What is the issue?

6 The request described government measures that apply to entities that produce or import passenger vehicles for sale in a specified market. Under the measures, entities receive positive credits if in a calendar year they have produced or imported vehicles whose average fuel emissions are lower than a government target, and negative credits if in that year they have produced or imported vehicles whose average fuel emissions are higher than the target.

7 The measures require an entity that receives negative credits for one year to eliminate those negative credits, either by purchasing positive credits from another entity or by generating positive credits itself in the next year (by producing or importing more low emission vehicles) and using those positive credits to eliminate the negative balance. If the entity fails to eliminate its negative credits in one or other of those two ways, the government can impose sanctions on the entity, for example restrict the entity's access to the market.

8 The request considered the position of an entity that has produced or imported vehicles with average fuel emissions higher than the government target, and asked whether such an entity has a present obligation that meets the definition of a liability in IAS 37.

IFRS IC's tentative conclusions (February 2022)

9 The IFRS IC concluded that an entity that has produced or imported vehicles with average fuel emissions higher than the government target has a legal obligation that meets the definition of a liability in IAS 37, unless accepting the sanctions that the government can impose is a realistic alternative to eliminating negative credits for that entity.

10 The IFRS IC considered the position of an entity that:

(a) has produced or imported vehicles with average fuel emissions higher than the government target; but

(b) does not have a legal obligation that meets the definition of a liability in IAS 37, because accepting sanctions is a realistic alternative for that entity, meaning the obligation cannot be enforced by law.

11 The IFRS IC concluded that such an entity nevertheless could have a constructive obligation that meets the definition of a liability in IAS 37.

12 The IFRS IC concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine whether, in the fact pattern described in the request, an entity has an obligation that meets the definition of a liability in IAS 37. Consequently, the IFRS IC [decided][1] not to add a standard-setting project to the work plan.

Tentative Agenda Decision Feedback

Cash received via an electronic transfer system

13 There are diverse views on when to recognise cash received via electronic transfer as settlement for a financial asset, where the electronic transfer system has a formal automated settlement process which takes more than one day to complete.

Fact pattern

14 Entity A's year-end is 31 December 20X0. In November 20X0, Entity A sells goods to Entity B and recognises a trade receivable of CU100. On 31 December 20X0, Entity B notifies Entity A that it has initiated the payment of CU100 by the UK BACS payment system to settle the amount due. On 2 January 20X1, Entity A receives CU100 into its bank account as cleared funds.

15 The question raised is: Is it acceptable for Entity A to recognise cash of CU100 (and derecognise the trade receivable) on 31 December 20X0?

16 In the IASB Staff view, both the trade receivable settled and the cash received are financial assets in the scope of IFRS 9. As a consequence:

- Entity applies derecognition requirements in IFRS 9 in determining when to derecognise the trade receivable.
- Entity applies initial recognition requirements in IFRS 9 in determining when to recognise cash as a financial asset.

[1] This reflects that the IFRS decisions in June are not final and this is shown also on the IFRS IC Update

17 This is different from the assumption underlying both views set out in the submission that no IFRS Standard specifically applies to the transaction, and consequently that the entity would develop an accounting policy applying paragraphs 10–11 of IAS 8.

18 The IASB Staff further provides the following analysis:

- Apply paragraphs 3.2.3 and 3.1.1 of IFRS 9 to determine when to derecognise the trade receivable and recognise cash as a financial asset, respectively. 3.1.2 of IFRS 9 is not applicable as there is no financial asset sale or purchase.
- Derecognise trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire and recognises the cash (or another financial asset) received as settlement for that trade receivable on that same date.
- Consider particular facts and circumstances—including the applicable laws and regulations and the characteristics of the electronic transfer system—in determining whether its contractual rights to the cash flows from the trade receivable expire on receipt of cash on the transfer settlement date, or earlier upon initiation of the cash transfer by the customer (or any date in between).

IFRS IC's tentative conclusions (September 2021)

19 In the fact pattern described in the request, the IFRS IC concluded that, applying paragraphs 3.2.3 and 3.1.1 of IFRS 9, the entity:

(a) derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and

(b) recognises the cash (or another financial asset) received as settlement for that trade receivable on the same date.

20 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine when to derecognise a trade receivable and recognise cash received via an electronic transfer system as settlement for that receivable. Consequently, the IFRS IC [decided] not to add a standard-setting project to the work plan.

Demand deposit with restrictions on use

21 There are diverse views on whether amounts held in a demand deposit should be presented as cash in the statement of financial position and the statement of cash flows when the entity is prevented from using the amounts to meet short-term cash commitments. The preliminary agenda decision on the topic of "Demand deposit with restrictions on use" is likely to be of high practical relevance.

Fact pattern

22 This submission considers a situation where the entity is required as a condition of the sale of a business to keep a specified amount of cash on deposit to indemnify the purchaser for potential warranty claims extending over several years. The entity (seller) has deposited the specified amount in a separate demand deposit account. The terms of the demand deposit account itself do not impose conditions restricting its use (i.e., if the entity requested the amount from the bank, it would obtain the amount immediately).

23 The question raised is: Should the specified amount in a separate demand deposit account be presented as cash and cash equivalents on the statement of financial position (IAS 1.54(i)) and on the statement of cash flows?

Inclusion as cash and cash equivalents in the statement of cash flows:

24 IAS 7 *Statement of Cash Flows* paragraph 6 includes a definition of cash. Cash 'comprises cash on hand and demand deposits.' IAS 7 includes no other

requirements on whether an item qualifies as cash beyond the definition itself. As indicated in IAS 7 and IAS 1 *Presentation of Financial Statements* amounts included in cash and cash equivalents may be subject to restrictions.

25 The IFRS IC concluded that restrictions on use of a demand deposit arising from a contract with a third party do not result in the deposit no longer being cash, unless those restrictions change the nature of the deposit in a way that it would no longer meet the definition of cash in IAS 7.

(a) Entity holds amounts in a demand deposit (see fact pattern), which meets the definition of 'cash' in paragraph 6 of IAS 7. The entity has a contractual obligation to use the amounts held in that demand deposit only for the purpose of indemnifying the buyer for future potential warranty claims. That contractual obligation does not change the nature of the asset the entity holds: the asset is a demand deposit because there are no restrictions on the entity's ability to access—on demand—amounts held in the deposit account.

(b) The contractual obligation restricts only the purpose for which the entity can use that asset. Therefore, the entity would include the demand deposit as a component of 'cash and cash equivalents' in its statement of cash flows.

Presentation in the statement of financial position:

(a) Applying paragraphs 54(i)1 and 55 of IAS 1, the entity presents the demand deposit with restrictions on use as cash and cash equivalents in its statement of financial position, unless presenting it separately in an additional line item is relevant to an understanding of the entity's financial position.

(b) However, if the demand deposit is restricted from being used to settle a liability for at least twelve months after the reporting period, then it would be presented as a non-current asset.

Disclosures

(a) Applying paragraphs 45 and 48 of IAS 7, the entity discloses the components of cash and cash equivalents and—together with a commentary by management—the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

(b) The entity would also consider whether to disclose additional information in the context of the requirements in IFRS 7 about liquidity risk arising from financial instruments and how an entity manages that risk.

IFRS IC's tentative conclusions (September 2021)

26 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine whether to include demand deposits subject to contractual restrictions on use agreed with a third party as a component of cash and cash equivalents in its statements of cash flows and financial position. Consequently, the IFRS IC [decided] not to add a standard-setting project to the work plan.

IASB Staff analysis and conclusions (March 2022)

27 The IASB received 17 comment letters and most of the respondents did not disagree with the technical analysis and conclusions in the tentative agenda decision. However, some expressed concerns about the classification outcomes of applying the tentative agenda decision. The IASB Staff recommend the IFRS IC to finalise the agenda decision with suggested (minor) changes.

Principal versus agent: Software resellers (IFRS 15)

28 The issue concerns all IT service providers worldwide who sell software licences to B2B customers under indirect contracts.

29 The submission deals with the question whether, when software licences are sold by third parties, i.e., by IT service providers or IT system houses, the respective third party is to be classified as principal or agent. Doubts arise especially with respect to contract models in which the third party is a value-added reseller and directly performs complex and extensive consulting services in advance within the scope of the contractually agreed performance (so-called indirect contract models).

30 The distinction made between the role of the principal and that of the agent of an entity has significant consequences for the presentation of the revenue in the income statement.

31 The question raised is: Should the value-added reseller in the indirect contract model be regarded as the principal or as the agent?

View 1: The Value-Added Reseller is the Principal

32 According to IFRS 15.24, the value-added reseller identifies the sale of a software licence as a promise in the customer contract. Moreover, the value-added reseller identifies the pre-sales consulting as an implicit promise to the customer pursuant to IFRS 15.24.

33 In summary, the following applies to the indirect contract model in the field of software licensing involving a value-added reseller (in accordance with IFRS 15 BC116J and the next paragraphs).

(a) The customer benefit only arises from the interaction or combination of the individual promises.

(b) From the perspective of the customer, the promise largely represents a single performance (= provision of a suitable and legally secure software solution).

(c) The consulting service directly and greatly influences the licence (and vice versa). Thus, consulting risks also give rise to licence risks. The value-added reseller bears the risk for the entire service package and may be held liable accordingly.

(d) The consulting thus has a significant impact on the customer benefit.

34 The value-added reseller comes to the conclusion that pre-sales consulting represents an implicit (significant) promise to the customer. The performance consists, not only of the sale of the standard software licence, but of a combined performance bundle comprising the standard software licence and the qualified consulting services of the value-added reseller.

View 2: The Value-Added Reseller is an Agent

35 This deviating interpretation of IFRS 15 does not assume the existence of a significant integration performance in the indirect business if the main purpose of the consulting service is to fulfil the licensing requirements of the software vendors.

36 The view that a pure agency activity is on hand is supported by the fact that in the context of the sale of standard software licences in the indirect business, a direct contractual relationship is instituted between the customer and the software vendor in addition to the contractual relationship between the customer and the value-added reseller and until then, the value-added reseller does not control the software licence. In this context, the pre-sales consulting would be regarded as a pure sales service on the part of the value-added reseller.

37 This reasoning can be supported as follows:

(a) The consulting service of the value-added reseller aims primarily at the software vendor's interest in due licensing.

(b) Compared to the value of the standard software licence, the pre-sales consulting overhead and the gross margin usually accounts for a minor share.

(c) Pre-sales consulting is provided even in cases in which the sale ultimately does not materialise. Thus, pre-sales consulting services are offered even without remuneration.

(d) A customer who knows which contract model would be suitable and how many standard software licences he or she needs would not gain any added value from the pre-sales consulting.

Submission conclusion

38 After considering the two views, the submission summarises that the licence is not sold alone, but as a combined performance bundle consisting of the licence and the qualified advice of the value-added reseller (i.e., a customer-specific licensing solution) for which the value-added reseller is responsible. The value-added reseller is the principal in the indirect contract model and presents the entire trading revenue.

IFRS IC's tentative conclusions (November 2021)

39 Identifying the specified goods or services to be provided to the customer: The IFRS IC concluded that, in the fact pattern described in the request, the promised goods in the reseller's contract with the customer are the standard software licences. Because the standard software licences are the only promised goods in the contract with the customer, they are distinct goods to be provided to the customer. Those licences are therefore the specified goods to be provided to the customer as described in paragraph B34A(a) of IFRS 15.

40 Assessing whether the reseller controls the standard software licences before they are transferred to the customer: The IFRS IC observed that the conclusion as to whether the reseller is a principal or agent depends on the specific facts and circumstances, including the terms and conditions of the relevant contracts. The reseller would apply judgement in making its overall assessment of whether it is a principal or agent—including considering the relevance of the indicators to the assessment of control and the degree to which they provide evidence of control of the standard software licences before they are transferred to the customer.

41 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for a reseller to determine whether - in the fact pattern described in the request—it is a principal or agent for the standard software licences provided to a customer. Consequently, the IFRS IC [decided] not to add a standard-setting project to the work plan.

Finalised Agenda decision subject to IASB approval

TLTRO III Transactions (IFRS 9 and IAS 20)

What is the issue?

42 The IFRS 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.

43 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.

44 Two views are expressed:

(a) View 1: TLTRO III transactions are loans at a below-market interest rate and include benefits which are treated as government grants according to IAS 20;

(b) View 2: TLTRO III transactions are accounted for as loans at a market interest rate according to IFRS 9.

45 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.

IFRS IC tentative conclusions (June 2021)

46 The IFRS IC concluded that if the bank determines that the TLTRO III tranches contain a government grant in the scope of IAS 20, the requirements in IAS 20 provide an adequate basis for an entity to determine how to account for that government grant.

47 With respect to the question of whether conditions attached to the interest rate should be reflected in the estimates and revisions of expected future cash flows when determining the effective interest rate, the IFRS IC concluded that the matters described in the request are part of a broader matter that, in isolation, are not possible to address in a cost-effective manner and should be reported to the IASB Board. The IASB Board should consider this matter as part of the post-implementation review of the classification and measurement requirements in IFRS 9.

48 For these reasons, the IFRS IC [decided] not to add a standard-setting project to the work plan.

IFRS IC conclusions (February 2022)

49 The IFRS IC considered feedback on the tentative agenda decision published in June 2021 and reached its conclusions on that agenda decision.

Initial consideration

Profit recognition for Annuity Contracts (IFRS 17)

50 The IFRS IC received a submission about the recognition of profit applying IFRS 17 Insurance Contracts. The submission asks how to determine the services provided under a group of immediate annuity contracts in each period and, more specifically, how to determine the quantity of benefits provided under each contract in the group. The submission refers to UK annuity contracts and the only service is insurance coverage for survival, i.e., the policyholder is entitled to a constant annual benefit starting from inception of the contract for as long as the policyholder survives.

51 The submission sets out two approaches and asks whether both approaches meet the principle in IFRS 17 of reflecting the insurance contract services provided under a group of insurance contracts. The quantity of the benefits provided in each period as being reflected by:

(a) Approach A - the constant annual benefit, that is, the contractual service margin (‘CSM’) allocation is determined based on the periodic benefit payable in each period that services are provided; and

(b) Approach B - the present value of the current and future benefits, that is, the CSM allocation is determined based on the value to the policyholder of surviving to the end of the period which includes both the annuity payment in the period as well as the continued access to receive a continuous stream of payments for as long as the policyholder survives.

IASB Staff analysis and recommendation

52 Approach A:

(a) Appendix A to IFRS 17 defines, among other items, the liability for incurred claims and the liability for remaining coverage. Both of those definitions describe insurance coverage as 'an entity's obligation to investigate and pay valid claims for insured events'.

(b) The IASB Staff conclude that Approach A meets the principle in paragraph B119[2] of IFRS 17 to reflect the insurance coverage provided under a group of annuity contracts in each period. This is because this measure of the quantity of the benefits:

(i) assigns a quantity of benefits only to periods in which the entity has an obligation to investigate and pay valid claims (for example, only to the period when the policyholder is entitled to receive the constant annual benefit under a deferred annuity contract); and

(ii) aligns the quantity of benefits with the amount of the valid claim that is a constant amount in each year.

53 Approach B:

(a) The IASB Staff conclude that Approach B does not meet the principle in paragraph B119 of IFRS 17 to reflect the insurance coverage provided under a group of annuity contracts. This is because this measure of the quantity of the benefits:

(i) assigns a quantity of the benefits to periods in which the entity has no obligation to investigate and pay valid claims (for example, to the period before the policyholder is entitled to receive the constant annual benefit of a deferred annuity contract), although it has accepted insurance risk; and

(ii) misrepresents the quantity of the benefits provided in a period by considering claim amounts the policyholder can access and benefit from only in future periods.

54 The IASB Staff recommend that the Committee not add a standard-setting project to the work plan but to publish a tentative agenda decision which would explain how to 'walk through' the applicable requirements.

Rent concessions: Lessors and Lessees

55 The IFRS IC received a submission about the application of IFRS 9 *Financial Instruments* and IFRS 16 *Leases* by both a lessor and a lessee in accounting for a particular rent concession. The rent concession results in the forgiveness by the lessor of amounts due from the lessee (comprising both amounts already recognised in receivables and future payments amounts not recognised as receivable) under the lease.

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[2] Paragraph B119 of IFRS 17 states: *An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the services provided under the group of insurance contracts in that period (see paragraphs 44(e), 45(e) and 66(e)). The amount is determined by:*

(a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of insurance contract services provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage period.

(b) allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the insurance contract services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.

(c) recognising in profit or loss the amount allocated to coverage units provided in the period.

56 For the lessor, the rent concession applies to a lease contract classified as an operating lease.

57 For the lessee, the rent concession applies a lease contract for which the lessee has recognised a right-of-use asset and a lease liability (i.e., the lessee has elected to apply neither of the recognition exemptions in paragraph 5 of IFRS 16).

58 Regarding the lessor accounting, the submitter asks:

(a) how the lessor applies the expected credit loss model in IFRS 9 to the operating lease receivable when the lessor expects to forgive payments due from the lessee under the lease before the rent concession is granted.

(b) whether the lessor applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

59 Regarding the lessee accounting, the submitter asks whether the lessee applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

Prevalence of the matter and diversity in practice

60 The IASB staff performed limited outreach to IFASS members, securities regulator, and large accounting firms

61 Regarding lessor accounting, many respondents said the lessor fact pattern is (or has been) common and the accounting has (or could have) a material effect. Of those who said it is common, most said it is common only in particular jurisdictions and industries and some said their observations are not specific to a jurisdiction or industry. Many also said they had observed no material diversity in accounting for the lessor fact pattern. Some respondents said they have observed material diversity that is not specific to a jurisdiction.

62 Regarding lessee accounting:

(a) Half of respondents said the lessee fact pattern is not common and the accounting has no material effect for lessees. Many said they have no experience with the fact pattern because lessees applied the covid-19-related practical expedient over recent years.

(b) The other half of respondents said the lessee fact pattern is (or could be) common and the accounting has (or could have) a material effect

(c) Many respondents said they had observed no material diversity in accounting for the lessee fact pattern. Some respondents said they have observed material diversity that is not specific to a jurisdiction or industry.

IASB Staff analysis and recommendation

63 Lessor accounting: do not add a standard-setting project to the work plan in relation to the lessor accounting and publish instead a tentative agenda decision that outlines how IFRS 9 and IFRS 16 apply in the lessor fact pattern described in the submission.

64 Lessee accounting: recommend to amend IFRS 16 (though annual improvements cycle) to exclude from the scope of IFRS 16 changes to a lease contract that result only in the extinguishment of the lessee's lease liability (or a part of it) as described in paragraph 3.3.1 of IFRS 9. For changes to lease contracts that result only in extinguishment, the lessee would apply the derecognition requirements in IFRS 9. For all other changes to lease contracts that meet the definition of a lease modification, the lessee would apply the lease modification requirements in IFRS 16.

Special Purpose Acquisition Companies (SPAC): Classification of Public Shares as Financial Liabilities or Equity

65 The submission asks about the impact on the classification of the Class B shares of the SPAC due to a right to demand reimbursement of the shares as well as the limited life of the SPAC and the related right to extend its life. The fact pattern are as follows:

(a) The SPAC, a listed entity established solely to acquire a target to be identified in the future, issues founder shares (Class A) and public shares (Class B);

(b) The decision to acquire an identified target is approved either by the shareholders or the management of the SPAC (per its statutes).

(c) On identification and approval of a target, the Class B shareholders individually may require the reimbursement of their shares (sometimes, only shareholders opposing the acquisition have this right).

(d) If there is no acquisition within a specified period of time, the SPAC is liquidated unless the statutes allow an extension of its life, and the shareholders approve.

(e) Upon liquidation, the net proceeds of the SPAC's IPO are distributed first to the Class B shareholders and the remainder to the Class A shareholders. In some cases, the Class B shareholders will also receive a minimum guaranteed return on the IPO proceeds.

(f) The decision to extend the SPAC's life is either approved by:

(i) ⅔ of the shareholders in a shareholders meeting; or

(ii) ⅔ of the Class A and B shareholders independently.

66 The submitter asks whether the condition in paragraph 16(a)(i) of IAS 32—which requires the instrument to include no contractual obligation to deliver cash or another financial asset—is met. The submitter therefore seeks to clarity on whether, and under what circumstances, a SPAC classifies the Class B shares as financial liabilities or equity instruments considering

(a) the effect of the Class B shareholders' right to demand a reimbursement of their shares (in the event of the acquisition of a company) and

(b) the effect of the terms and conditions of the SPAC's liquidation after a specified period of time (without an acquisition) on the classification of the Class B shares.

IASB Staff analysis and recommendation

67 No outreach was done as the IASB Staff is aware of the significant increase in the number of SPACS and similar mechanisms and is also aware of the differing views. The IASB Staff consider that the issue raised in the submission is part of a broader practice issue and should not be analysed in isolation. Otherwise, there could be unintended consequences for different fact patterns.

68 Therefore, the IASB Staff recommends the publication of a tentative agenda decision that explains that the matter:

(a) is too narrow to consider in isolation because it is part of a broader practice issue;

(b) cannot be resolved efficiently within the confines of the existing Accounting Standards and the Conceptual Framework; and

(c) is better suited to be addressed as part of the IASB's FICE project.

Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition

69 The IFRS IC received a request about the acquisition of a special purpose acquisition company (SPAC) by an operating company. The request asked how the operating entity accounts for warrants (right, but not the obligation, to buy or sell equity at a certain price before expiration) on acquiring the SPAC.

70 The fact pattern described in the submission is:

(a) The SPAC was created to raise cash in an initial public offering (IPO). At the time of the acquisition, SPAC has no assets other than cash;

(b) The SPAC does not meet the definition of a business in accordance with IFRS 3 *Business Combinations*;

(c) Before the acquisition, the SPAC's ordinary shares were held by its founder shareholders and public investors;

(d) Before the acquisition, the SPAC issued warrants to both its founder shareholders and public investors;

(e) To carry out the acquisition, the operating entity sets up a new parent company (NewCo);

(f) The NewCo acquires the SPAC by issuing new ordinary shares and warrants to the SPAC's founder shareholders and public investors in exchange for the SPAC's ordinary shares and the cancellation of the SPAC's warrants;

(g) The fair value of the instruments the NewCo issues to acquire the SPAC exceeds the fair value of the identifiable net assets of the SPAC.

(h) The SPAC becomes a wholly-owned subsidiary of the NewCo.

(i) The NewCo replaces the SPAC as the entity listed in the stock exchange.

71 The submitter asks whether, in the fact pattern described in the submission, the warrants NewCo issues to SPAC shareholders:

(a) are in the scope of IFRS 2 or represent a liability assumed by the entity as part of the acquisition; and

(b) if the warrants are in the scope of IFRS 2, whether they remain so after the acquisition date.

IASB Staff analysis and recommendation

72 In the fact pattern discussed, the IASB staff concluded that the "acquisition method" under IFRS 3 cannot be applied by the NewCo as the transaction does not meet the definition of a business combination (SPAC is not a business).

73 Instead, the NewCo has to identify and recognise the individual identifiable assets acquired and liabilities assumed as part of the acquisition. That is, the NewCo considers:

(a) Acquired assets: the acquired cash held by the SPAC

(b) Liabilities assumed: assess whether it assumes any liability related to the warrants issued by the SPAC to its founder shareholders and public investors.

74 In regard to the warrants issued by the SPAC, depending on the terms and conditions, the NewCo may or not assume the SPAC warrants as part of the acquisition.

<u>The NewCo assumes warrants as part of the acquisition and then replaces them with new warrants</u>

75 If the terms and conditions are such that the entity assumes the warrants issued by the SPAC as part of the acquisition, the entity applies IAS 32 to determine whether the warrants are financial liabilities or equity instruments.

76 Nonetheless, it is worth noting that the NewCo negotiated the replacement of the SPAC warrants together with the SPAC acquisition. Therefore, the NewCo has to consider to what extent it accounts for the replacement transaction as part of that acquisition (there are no requirements in IFRS Accounting Standards that specifically apply to this consideration).

77 If an entity concludes that it accounts for the replacement transaction separately from the SPAC acquisition, then the NewCo would first account for the SPAC warrants it assumes as part of the acquisition, and then separately account for their replacement.

78 If an entity concludes that it does not account for the replacement transaction separately, then the entity issues new ordinary shares and warrants to only acquire cash and a stock exchange listing service received (see the accounting for in section below The NewCo does not assume warrants as part of the acquisition).

79 In the fact pattern discussed, the fair value of the instruments the entity issues to acquire the SPAC exceeds the fair value of the identifiable net assets of the SPAC acquired. The IASB Staff concluded that, applying paragraphs 2 and 13A of IFRS 2, the NewCo:

(a) receives a stock exchange listing service for which it has issued equity instruments as part of a share-based payment transaction; and

(b) measures the stock exchange listing service received as the difference between the fair value of the instruments issued to acquire the SPAC and the fair value of the identifiable net assets acquired.

80 The IASB Staff therefore concluded that when the NewCo assumes warrants as part of the acquisition (and then replaces them with new warrants), then NewCo applies:

(a) IFRS 2 in accounting for instruments issued to acquire the stock exchange listing service; and

(b) IAS 32 in accounting for instruments issued to acquire cash and assume any liabilities related to the SPAC warrants—those instruments were not issued to acquire goods or services and are not in the scope of IFRS 2

(c) IFRS 9 in accounting for the replacement of the warrants (if any).

<u>The NewCo does not assume warrants as part of the acquisition</u>

81 If the entity concludes that the terms and conditions are such that it does not assume the SPAC warrants as part of the acquisition, the NewCo issues both ordinary shares and warrants to acquire cash and a stock exchange listing service.

82 In accordance with the requirements in IAS 32 and IFRS 2, the entity applies IFRS 2 in accounting for shares and warrants issued to acquire the stock exchange listing service and IAS 32 in accounting for the shares and warrants issued to acquire cash.

83 In this case, the entity has to determine which instruments it issued to acquire the cash and which it issued to acquire the stock exchange listing service. There is no IFRS Accounting Standard that specifically applies to this determination. Nonetheless, the IASB Staff observed that:

(a) an entity would not make this determination solely to achieve a particular accounting outcome; and

(b) an entity could allocate the shares and warrants to the acquisition of cash and the stock exchange listing service on the basis of the relative fair values of the instruments issued (that is, in the same proportion as the fair value of each type of instrument to the total fair value of all issued instruments).

<u>IASB Staff recommendation</u>

84 The IASB Staff concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine - in the fact pattern and variation discussed - how to account for warrants on acquiring a SPAC.

85 Consequently, the IASB Staff suggested not to add a standard-setting project to the work plan and that the Committee instead publish a tentative agenda decision that outlines how IFRS Accounting Standards apply in the submitted fact pattern and the variation thereof.

Items for future consideration

Valuation of lease payments based on the cadastral value (IFRS 16)

Background

86 Lease payments in land leases (e.g., from municipal, regional or federal authorities) are often determined based on the valuations of the land plots recorded in the state register (cadastre). The procedure and frequency of cadastral valuation are stipulated by the federal legislation.

87 The contractual lease payments are determined by multiplying the cadastral value by certain coefficients, applicable to a region where the land is located, type of land use, or by an inflation index. Moreover, local authorities may apply additional adjusting coefficients for the lease pricing. The coefficients may change from time to time. The cadastral values and the coefficients are determined by the local authorities and are publicly available.

88 The lease payments are generally adjusted upon each change of the cadastral value. In practice, such revaluations may result in an upward or downward adjustment.

89 According to paragraphs 27 and 28 of IFRS 16 *Leases*, the measurement of the lease liability includes only those variable lease payments that depend on an index or a rate. Under paragraph 28 of IFRS 16, variable lease payments that depend on an index or a rate include, in particular, payments linked to a consumer price index, or a benchmark interest rate (such as LIBOR), or payments that vary to reflect changes in market rental rates.

What is the issue?

90 In the submission, the question is how should the lessee treat lease payments linked to cadastral value when measuring the lease liability.

91 There are different views as follows based on current practice:

(a) *View A – Variable lease payments, not depending on an index or a rate*

Cadastral valuation is performed based on the decision of local authorities and the current cadastral valuation does not necessarily reflect the current market environment, although a revaluation may be required under certain circumstances to address market changes. Also, cadastral value of the land is not used by the market participants to determine the price of a land plot.

Therefore, lease payments linked to cadastral value do not depend on an index or a rate and are not reflected in the measurement of the lease liability. This approach is widely used in practice whereby the lease payments are instead, recorded as operating expenses over the lease term.

(b) *View B – Variable lease payments, depending on an index or a rate*

Some entities consider lease payments linked to the cadastral value of land to be variable payments that depend on an index or a rate. This is because they consider that, by law, the cadastral value is determined based on the market or other information related to the economics of the land use. Cadastral value is deemed to be a valuation closest to the market value which — together with the assumption that application of coefficients represents a market mechanism. Also, cadastral values and coefficients are determined by the government agencies and are publicly available.

Therefore, lease payments linked to cadastral value are similar in nature to lease payments dependent on an index or a rate, and such future lease payments are included in the measurement of the lease liability at the lease commencement date.

(c) *View C - Lease payments include an in-substance fixed element*

Some entities consider lease payments linked to the cadastral value of land to be in-substance fixed in case if the contract provides lessor with a right but not an obligation to change lease payments when there is a change in either cadastral value or coefficients. These entities believe that lessor's right to avoid a decrease in initially determined lease payments creates an in-substance-fixed component of the contractual lease payments.

Therefore, such future lease payments are not included in the measurement of the lease liability at the lease commencement date.

Questions for the EFRAG CFSS and EFRAG TEG members

92 Do you have any comments on the topics presented?

93 Do you wish to further discuss any of the presented issues at a future meeting?