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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' or the 'Committee').

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 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 CFSS's technical assessment on the matters.

4 If EFRAG FR TEG or EFRAG 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**<br>**(including hyperlinks to the IASB project pages for each item)** | **Related Standards** | **Current status** | **Next milestone** | **Next milestone expected date** |
|---|---|---|---|---|
| **Initial consideration** | | | | |
| Guarantee over a Derivative Contract | IFRS 9 | March 2023 IFRS IC meeting | Consultation | Not specified |
| Premiums Receivable from an Intermediary | IFRS 17<br>IFRS 9 | March 2023 IFRS IC meeting | Consultation | Not specified |
| Homes and Home Loans Provided to Employees | IAS 19<br>IFRS 9 | March 2023 IFRS IC meeting | Consultation | Not specified |
| Potential annual improvements to IFRS Accounting Standards:<br>- Lessee accounting for lease payments forgiven | IFRS 9 and IFRS 16<br>IFRS 7 | March 2023 IFRS IC meeting | Consultation | Not specified |

| **Project (including hyperlinks to the IASB project pages for each item)** | **Related Standards** | **Current status** | **Next milestone** | **Next milestone expected date** |
|---|---|---|---|---|
| - Disclosure of deferred difference between fair value and transaction price | | | | |
| **Tentative Agenda Decision Feedback** | | | | |
| Definition of a Lease: Substitution Rights | IFRS 16 | Consultation ended 6 February 2023 | Tentative Agenda Decision Feedback | March 2023 |
| **Input on IASB project** | | | | |
| Business Combinations—Disclosures, Goodwill and Impairment | IFRS 3<br>IAS 36 | March 2023 IFRS IC meeting | Publish ED | Not specified |
| **Decide project direction** | | | | |
| Consolidation of a Non-hyperinflationary Subsidiary by a Hyperinflationary Parent | IAS 21<br>IAS 29 | Further research and outreach being done | Decide project direction | Not specified |
| **Items for future consideration** | | | | |
| Merger between a parent and its subsidiary in separate financial statements | IAS 27 | In IASB pipeline | Not specified | Not specified |

### Initial consideration

*Guarantee over a Derivative Contract*

*Issue and background*

6 A financial guarantee contract is defined in Appendix A to IFRS 9 as *"[a] contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.*"

7 A derivative is defined in Appendix A to IFRS 9 as follows: "*A financial instrument or other contract within the scope of this Standard with all three of the following characteristics.*

(a) *its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').*

(b) *it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.*

(c) *It is settled at a future date.*"

8 The IFRS IC received a submission about whether, applying IFRS 9 Financial Instruments, an entity accounts for a guarantee over a derivative contract as a financial guarantee contract or a derivative. Specifically, the submission asked

about the accounting for the guarantee by the entity writing the guarantee (the issuer).

9 The submitted fact pattern can be summarised as follows:

(a) Entity A has entered into an interest rate derivative contract for two years with Entity B. The amounts due by Entity A under the pay leg and the amounts due to Entity A under the receive leg are net settled on a quarterly basis in arrears.

(b) Entity C writes a guarantee to Entity A over the derivative contract for the same two years in exchange for a premium.

(c) In the event of a default of either counterparty, the derivative is immediately terminated, and a fixed close-out amount is determined in accordance with the terms of the derivative contract and is based on a valuation of the remaining contractual cash flows of the derivative prior to default. Once determined, the fixed close-out amount is due and payable and does not accrue interest.

(d) Entity C will provide a reimbursement under the guarantee only if the derivative contract is a financial asset for Entity A and Entity B has failed to make a payment of the fixed close-out amount when due in full or in part.

(e) The maximum amount of reimbursement provided under the guarantee is not specified and will fluctuate based on the changes in the fair value of the derivative contract. A pay-out under the guarantee will only be made in respect of losses actually suffered by Entity A due to non-payment of the fixed close-out amount by Entity B.

10 Question: Does the guarantee contract written by Entity C meet the definition of a financial guarantee contract? If the definition of a financial guarantee is not met, is the guarantee contract a derivative in the scope of IFRS 9?

11 In the fact pattern, the submitter outlines different views.

*Findings from information requests*

12 Information requests were sent to the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms, from which 19 responses were received (ten from national standard-setters, five from large accounting firms, two from securities regulators, one from an organisation representing a group of securities regulators, and one from a financial institution).

13 Is the fact pattern common or widespread? All respondents said that the writing of a guarantee over a derivative, as described in the submission, is not common or widespread. However, two accounting firms said there are limited situations in which the fact pattern described in the submission have occurred in the banking or insurance industry in some jurisdictions. One standard-setter also mentioned that such transaction might become more common in their jurisdiction in the future.

14 If it is common, are the amounts involved material on the issuing entity's financial statements? Almost all respondents said that there are no material effects on financial statements given such a fact pattern is not common. Only one respondent (an accounting firm) said such transactions could have a material effect to the entities concerned, similar to the effects seen during the financial crisis when similar transactions were executed by banks.

15 Is there a diversity in practice in how entities apply the relevant IFRS Accounting Standards to the fact pattern? A few respondents (some standard-setters and one accounting firms) noted that there could be potential diversity in practice as a result of different views expressed by different accounting firms (the prevalent view is that for such a guarantee over a derivative contract the IFRS 9 requirements would theoretically apply). However, no information was provided on whether the potential diversity in practice would be expected to have a material effect.

*IASB Staff analysis and recommendations*

16 The IASB Staff notes that the finding from the respondents shows that:

(a) the fact pattern described in the submission is not common; and

(b) there is no evidence that the use of a guarantee over a derivative contract is widespread in practice or is expected to have a material effect on those affected.

17 Furthermore, the IASB Staff considers that the alternative views described by the submitter, focus on whether the guarantee is written over a 'debt instrument' as referenced in the definition of a financial guarantee contract. Therefore, any potential standard-setting project to eliminate diversity in practice would extend beyond the fact pattern described in the request and could result in significant unintended consequences when applying the requirements for financial guarantee contracts more generally.

18 The IASB Staff concludes that:

(a) the matter does not meet the criteria to add a standard-setting project to the IASB work plan (paragraph 5.16(a) of the Due Process Handbook states that: "the matter has widespread effect and has, or is expected to have, a material effect on those affected"); and

(b) the matter described in the request is, in isolation, too narrow for the IASB or the IFRS IC to address in a cost-effective manner.

19 Therefore, the IASB Staff recommends the IFRS IC not to add a standard-setting project to the workplan. Instead, the IASB Staff recommends the IFRS IC publishes a tentative agenda decision that explains its reasons for not adding a standard-setting project.

20 This topic will be discussed at the 14-15 March IFRS IC meeting.

*Premiums Receivable from an Intermediary*

*Issue and background*

21 The IFRS IC received two submissions about how an entity that issues insurance contracts (insurer) applies the requirements in IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments* to premiums receivable from an intermediary.

22 The submissions ask, when the policyholder pays the premiums to the intermediary, is an insurer required to recognise the premiums receivable from an intermediary as a separate financial asset under IFRS 9 and remove these premiums from the measurement of the group of insurance contracts under IFRS 17. This issue is also applicable for the premium allocation approach[1].

23 The submissions identify that the treatment affects the presentation of the premiums receivable in the statement of financial position and the timing of the recognition of any loss on the receivable in the statement of profit or loss when an insurer does not expect to recover amounts from an intermediary.

*Findings from information requests*

24 Information requests were sent to the Transition Resource Group for IFRS 17, from which 13 responses were received. Input was also received from two preparers, an accountancy body and a regulator.

[1] Under the premium allocation approach, IFRS 17 requires an entity to increase the liability for remaining coverage with premiums received (instead of an estimate of all future premiums).

25 Is the fact pattern common? All respondents stated that it is common in all jurisdictions and for all types of insurance contracts for an intermediary to act as a link between an insurer and a policyholder.

26 Are premiums receivable from an intermediary material? Most respondents say the amount of premiums receivable from an intermediary at a reporting date can be substantial. Some respondents say this is true particularly for non-life insurance and reinsurance contracts issued. Under life insurance (and some retail non-life insurance) the amount of premiums receivable is not as substantial because a policyholder pays premiums directly to an insurer or in instalments.

27 How do insurers apply the requirements in IFRS 17 and IFRS 9 to premiums receivable from an intermediary? Six respondents say insurers keep premiums receivable from an intermediary within the measurement of a group of insurance contracts until the insurer receives the premiums in cash.

28 Ten respondents are of the view that, in the submitted fact pattern, when a policyholder pays the premiums to an intermediary the policyholder has discharged its obligation under the insurance contract and becomes entitled to the insurance contract services; it is as if the policyholder paid the insurer. Therefore, the insurer recognises the premiums receivable from an intermediary as a separate financial asset under IFRS 9.

29 How do insurers apply the requirements in IFRS 17 and IFRS 9 to other amounts due to or from a party other than the policyholder? Ten respondents said that insurers keep within the measurement of a group of insurance contracts all cash flows within the boundary of an insurance contract (including premiums) that, after the inception of the contract, become due to or from a party other than policyholders. These receivables/payables are the removed from the IFRS 17 measurement once they are recovered or settled in cash. While five respondents remove from the measurement cash flows due to or from a party other than policyholders.

*IASB Staff analysis and recommendations*

30 IFRS 17 is the starting point for the premiums receivable from an intermediary.

31 The submissions have two views on when an insurer removes premiums receivable from an intermediary from the measurement of a group of insurance contract:

(a) **View 1** - an insurer removes the premiums receivable only when the insurer receives the premiums in cash.

(b) **View 2** - an insurer removes the premiums receivable when the policyholder pays in cash the premiums to the intermediary and recognises a separate financial asset applying IFRS 9.

32 IFRS 17 is silent on when cash flows included within the measurement of a group of insurance contracts are removed from that measurement. By implication, amounts of cash flows are removed from that measurement when they are recovered or settled.

33 The IASB Staff hold the view that an insurer removes expected cash flows from the measurement of a group of insurance contracts under IFRS 17: (a) when the cash flows are recovered or settled; or (b) when the cash flows are recognised as an asset or a liability applying another IFRS Accounting Standard.

Relation with IFRS 9

34 Neither IFRS 17 nor IFRS 9 provides a mechanism to bring receivables and payables for cash flows that have already been included within the measurement of a group of insurance contracts back into the scope of IFRS 9. In other words, as long as rights and obligations (and related cash flows) are accounted for under IFRS 17, they are excluded from the scope of IFRS 9. Therefore, the IASB Staff considers that an insurer therefore keeps within the measurement of a group of

insurance contracts premiums receivable from an intermediary until the amounts are recovered in cash.

35 However, there is another interpretation whereby after the policyholder has discharged its obligation to pay the premiums (by paying them to the intermediary) and the insurer has accepted the obligation to provide the insurance contract services under the insurance contract, it is possible to argue that the receivable under the insurance contract has been recovered by the receipt of a different receivable – receivable from the intermediary which should be recognised under IFRS 9 and the respective cash flow would be removed from the measurement of the group of insurance contracts.

IASB Staff recommendation

36 The IASB Staff indicate that it may be necessary to add or change requirements in IFRS Accounting Standards because an alternative interpretation of IFRS 17 and IFRS 9 cannot be precluded in the fact pattern submitted. However, any project would not be narrow in scope. Also, there is no sufficient evidence that the outcomes of applying the two views outlined in IASB Staff paper would be expected to have a material effect on the amounts that entities report. Therefore, the IASB Staff recommend not to add a standard-setting project to the work plan.

37 This topic will be discussed at the 14-15 March IFRS IC meeting.

*Homes and Home Loans Provided to Employees*

*Issue and background*

38 The IFRS IC received a submission to clarify the accounting for the following two scenarios:

(a) **Scenario 1** - homes provided by the employer to its employees in return for forgoing a contractual housing allowance (typically paid by employer in such conditions), and a proportional deduction in employee's salary.

(b) **Scenario 2** - loans provided by the employer to its employees to enable them to buy homes, provided at a below-market-rate or interest-free, repaid by the employee through salary deductions.

*Initial outreach research*

39 The IASB Staff published an information request asking whether the fact patterns are common, typically material for involved entities, and about the accounting for such scenarios. They received 15 responses – seven from accounting firms, seven from national standard-setters and one from an organisation representing a group of securities regulators.

*IASB Staff analysis and recommendations*

40 The IASB Staff has not technically analysed the accounting for both scenarios. Instead, they concluded that:

(a) Regarding **Scenario 1** – such scenarios are not common, and the amounts involved are not material. Limited diversity has been observed.

(b) Regarding **Scenario 2** – such scenarios are not common, or the amounts involved are not material. Only limited diversity related to income statement presentation has been observed.

41 Consequently, the IASB Staff proposes the IFRS IC not to add the issues to the IFRS IC technical agenda and, instead, to publish an agenda decision that explains its reasons for not adding a standard-setting project as explained above.

42 This topic will be discussed at the 14-15 March IFRS IC meeting.

*Potential annual improvements to IFRS Accounting Standards*

*Lessee accounting for lease payments forgiven (IFRS 9 and IFRS 16)*

Issue and background

43 At its March 2022 meeting, the IFRS IC discussed a request about a lessor's and a lessee's application of IFRS 9 Financial Instruments and IFRS 16 Leases in accounting for a rent concession in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under the contract.

44 The lessor's application of IFRS 9 and IFRS 16 was addressed by the IFRS IC in its Agenda Decision Lessor Forgiveness of Lease Payments (IFRS 9 and IFRS 16) published in October 2022.

45 The lessee accounting was also discussed in March 2022, please see paper AP 4 for more details.

Fact pattern (lessee accounting only)

46 The IFRS IC received a request that described a rent concession agreed by a lessor and a lessee on the date the rent concession is granted. The rent concession changes the original terms and conditions of a lease contract. The lessor legally releases the lessee from its obligation to make specifically identified lease payments. No other changes are made to the lease contract, nor are there any other negotiations between the lessor and the lessee that might affect the accounting for the rent concession.

47 Until the date of being granted the rent concession, the lessee had recognised the payments forgiven as part of its lease liability. The lessee has not elected to apply the COVID-19-related practical expedient in paragraphs 46A - 46B of IFRS 16[2].

48 The request asked whether the lessee applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for the rent concession.

IASB Staff analysis and recommendations

49 IASB Staff concluded that there is more than one way for a lessee to read the principles and requirements in IFRS Accounting Standards in accounting for the rent concession in the submitted fact pattern.

50 The lessee could:

(a) apply paragraphs 3.3.1 and 3.3.3 of IFRS 9 to the part of the lease liability that is extinguished and paragraphs 45 - 46 of IFRS 16 in accounting for the lease modification (after having applied the derecognition requirements in IFRS 9 to the part of the lease liability extinguished). Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments in profit or loss at the date on which the rent concession is granted.

(b) account for the forgiveness of lease payments by applying the lease modification requirements in IFRS 16. Such an approach would result in the lessee recognising the effect of the forgiveness of lease payments as a decrease in the carrying amount of the right-of-use asset.

51 To remove the above ambiguity, the IFRS IC agreed to consider a narrow-scope standard-setting project, potentially as an annual improvement to clarify whether a

[2] The practical expedient applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of several conditions are met, including that any reduction in lease payments affects only payments originally due on or before 30 June 2022.

lessee applies IFRS 9 or IFRS 16 in accounting for a rent concession described in the fact pattern above.

Potential amendments to IFRS 16

52 Appendix A to IFRS 16 defines 'lease modification' as: "*A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).*"

53 The IASB Staff recommend amending the definition of 'lease modification' to exclude from that definition, for a lessee, a change that solely results in a lease liability (or a part of it) being extinguished in accordance with IFRS 9 (the new text is underlined).

> **lease modification**
>
> A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term). For a lessee, a change that results solely in a lease liability (or a part of it) being extinguished in accordance with IFRS 9 is not a lease modification.

54 As a result of such an amendment:

(a) the lessee would apply the derecognition requirements in IFRS 9 for a change to a lease contract that solely results in a lease liability (or a part of it) being extinguished; and

(b) the lessee would apply the lease modification requirements in IFRS 16 for all other changes to a lease contract that meet the definition of a lease modification.

Potential amendments to Illustrative Example 19 accompanying IFRS 16

55 The IASB Staff also considered, on the request of some IFRS IC members, whether to change the Illustrative Example 19 ('IE 19') to IFRS 16 which illustrates a lease 'modification that is a change in consideration only'. In this example the lessee accounts for a decrease in lease consideration as a lease modification applying IFRS 16; it remeasures the lease liability and recognises a corresponding adjustment to the right-of-use-asset.

56 Paragraph B3.3.1 of IFRS 9 states: "A financial liability (or part of it) is extinguished when the debtor either:

(a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

(b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met)."

57 In the fact pattern in IE 19, at the beginning of year 6 of a 10-year lease, a lessee and a lessor agree to amend the lease contract for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year - a reduction of CU5,000 per year. No other changes are made to the lease contract.

58 The IASB Staff concluded that the change in lease consideration illustrated in IE 19 would continue to be a lease modification, as the requirements in paragraph B3.3.1 of IFRS 9 for extinguishment of that liability have not been met. For the CU5,000 - the reduction per year in lease payments under the lease contract - the lessee has not discharged that liability by paying the lessor, and therefore paragraph B3.3.1(a)

has not been met. The lessor has not legally released the lessee from primary responsibility for that liability, and therefore paragraph B3.3.1(b) has not been met. Instead, the change to consideration under the lease contract is a lease modification applying IFRS 16, as illustrated in that example.

59 Therefore, the IASB Staff does not propose any changes to IE 19.

Potential amendments to IFRS 9

60 Paragraph 2.1(b)(ii) of IFRS 9 states that 'lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 3.3.1' of IFRS 9.

61 Paragraph 3.3.1 of IFRS 9 states that 'an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished … '.

62 Paragraph 3.3.3 of IFRS 9 states that 'the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished … and the consideration paid, including any non cash assets transferred or liabilities assumed, shall be recognised in profit or loss'.

63 Applying the above to the fact pattern in the submission, the IASB Staff would expect that that a lessee that has applied paragraph 3.3.1 of IFRS 9 would apply paragraph 3.3.3 of IFRS 9 to determine the amount to be recognised in profit or loss. Assuming that the lack of a cross-reference to paragraph 3.3.3 in paragraph 2.1(b)(ii) of IFRS 9 was an oversight, the IASB Staff proposes to amend paragraph 2.1(b)(ii) as follows (the new text is underlined):

> 2.1 This Standard shall be applied by all entities to all types of financial instruments except:
>
> …
>
> (b) rights and obligations under leases to which IFRS 16 *Leases* applies.
>
> However:
>
> …
>
> (ii) lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraphs 3.3.1 <u>and 3.3.3</u> of this Standard; and
>
> …

Does this matter meet the annual improvements criteria?

64 Paragraphs 6.10–6.13 of the Due Process Handbook include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:

(a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or

(b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.

65 In the IASB Staff's view, the proposed solution to amend the definition of 'lease modification' in Appendix A to IFRS 16 and to amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9 meets these criteria.

66 Such amendments would:

(a) efficiently resolve the conflict between the derecognition requirements in IFRS 9 and the lease modification requirements in IFRS 16 that arise when a lessee accounts for the rent concession in the submitted fact pattern;

(b) correct an unintended oversight in cross-referencing between paragraphs within IFRS 9 and resolve potential confusion for a lessee applying the derecognition requirements in IFRS 9; and

(c) not propose a new principle or change an existing principle.

<u>Summary of IASB Staff preliminary views</u>

(a) to propose that the IASB amend the definition of 'lease modification' in Appendix A to IFRS 16;

(b) to propose that the IASB amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of IFRS 9; and

(c) to include these proposed amendments in the next annual improvements cycle.

67 This topic will be discussed at the 14-15 March IFRS IC meeting.

*Disclosure of deferred difference between fair value and transaction price—Guidance on implementing IFRS 7*

<u>Issue and background</u>

68 IFRS IC was informed about an inconsistency between paragraph 28 of IFRS 7 *Financial Instruments: Disclosures* and paragraph IG14 of its accompanying illustrative guidance in the Guidance on implementing IFRS 7.

69 This inconsistency arose when, upon the issuance of IFRS 13 *Fair Value Measurement* in May 2011, the IASB made a consequential amendment to paragraph 28 of IFRS 7 but made no corresponding amendments to paragraph IG14 of IFRS 7.

70 Paragraph B5.1.2A(b) of IFRS 9 *Financial Instruments* requires an entity to defer a difference between the fair value at initial recognition of a financial instrument and its transaction price if the fair value is not evidenced by a quoted price in an active market for an identical instrument or based on a valuation technique that uses only data from observable markets. The entity recognises that deferred difference in profit or loss in subsequent periods only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the instrument. The requirements in paragraph B5.1.2A of IFRS 9 were previously in paragraph AG76 of IAS 39 *Financial Instruments: Recognition and Measurement* (as amended at October 2009).

71 The IASB issued IFRS 13 in May 2011 and made consequential amendments to several IFRS Accounting Standards, including to paragraph AG76 of IAS 39 (now paragraph B5.1.2A of IFRS 9) and paragraph 28 of IFRS 7.

72 As a result of that amendment, paragraph 28 of IFRS 7 states:

*"In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of IFRS 9). In such cases, the entity shall disclose by class of financial asset or financial liability:*

(a) *its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9).*

(b) *the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.*

(c) *why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value*."

73 Paragraph IG14 of IFRS 7 illustrates some of the disclosure requirements in paragraph 28 of IFRS 7. Paragraph IG14 of IFRS 7 states, in part:

*"At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IFRS 9 Financial Instruments and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. »*

74 The first two sentences of paragraph IG14 of IFRS 7 reflect the wording in paragraph 28 of IFRS 7 before it was amended by IFRS 13. As a result, some of the wording in paragraph IG14 is not consistent with wording in paragraph 28 of IFRS 7.

IASB Staff analysis and recommendations

75 In the IASB Staff's view, this matter can be efficiently resolved by amending paragraph IG14 of IFRS 7 to better align its wording with paragraph 28 of IFRS 7 (see below). The IASB Staff does not recommend, to include amendments to paragraph IG14 of IFRS 7 to illustrate the disclosure requirement in subparagraph 28(c) of IFRS 7[3].

76 New text is underlined and deleted text is struck through.

"~~At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique.~~ In some cases, the transaction price of a financial instrument differs from its fair value at initial recognition, and that fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) nor is based on a valuation technique that uses only data from observable markets. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IFRS 9 Financial Instruments and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with some of the requirements in paragraph 28:

**Background**

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

[3] At its February 2023 meeting, the IASB tentatively decided to propose an amendment to paragraph IG1 of IFRS 7 to add a statement that the implementation guidance accompanying IFRS 7 does not illustrate all the requirements in IFRS 7.

The transaction price is ~~of~~ CU15 million ~~is the fair value at initial recognition~~.

The entity determines that the transaction price does not represent the fair value of the financial assets at ~~After~~ initial recognition.~~,~~ The ~~the~~ entity applies ~~will apply~~ a valuation technique to measure the financial assets' fair value. This valuation technique uses inputs other than data from observable markets.

At initial recognition, the fair value of the financial assets measured using that ~~same~~ valuation technique is ~~would have resulted in an amount of~~ CU14 million, which differs from the transaction price ~~fair value~~ by CU1 million.

The entity has existing differences yet to be recognised in profit or loss of CU5 million at 1 January 20X1.

**Application of requirements**

The entity's 20X2 disclosure would include the following:

*Accounting policies*

The entity uses the following valuation technique to measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between ~~the fair value at initial recognition (which, in accordance with IFRS 13 and IFRS 9, is generally the~~ transaction price~~)~~ and the fair value measured ~~amount determined~~ at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

*In the notes to the financial statements*

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IFRS 9, the fair value of an instrument at initial recognition ~~inception~~ is normally the transaction price. If the transaction price differs from the fair value measured ~~amount determined~~ at initial recognition ~~inception~~ using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognised in profit or loss are as follows:

| | **31 Dec X2** | **31 Dec X1** |
|---|---|---|
| | CU million | CU million |
| Balance at beginning of year | 5.3 | 5.0 |
| New transactions | – | 1.0 |
| Amounts recognised in profit or loss during the year | (0.7) | (0.8) |
| Other increases | – | 0.2 |
| Other decreases | (0.1) | (0.1) |
| Balance at end of year | 4.5 | 5.3 |

Does this matter meet the annual improvements criteria?

77 Paragraphs 6.10–6.13 of the Due Process Handbook include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:

(a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or

(b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.

78 In the IASB Staff's view, the proposed solution to amend paragraph IG14 of IFRS 7 meets these criteria and would efficiently resolve the matter. Such an amendment would improve consistency between paragraph 28 and its illustrative guidance in paragraph IG14 of IFRS 7. It would not propose a new (or change an existing) principle or requirement.

79 The IASB Staff also notes that, strictly speaking, an amendment to the Guidance on implementing IFRS 7 may not be required - because such guidance accompanies, but is not part of, an IFRS Accounting Standard. However, there is benefit in removing the potential for confusion related to paragraph IG14 of IFRS 7 and given that the IASB already previously amended the non-mandatory material, such as Illustrative Example 13 to IFRS 16, the IASB Staff proposes to proceed with this minor amendment.

**Tentative Agenda Decision Feedback**

*Definition of a Lease: Substitution Rights (IFRS 16)*

*Issue and background*

80 IFRS 16 defines a lease as «a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration» (Appendix A to IFRS 16). Paragraph B14 of IFRS 16 states that «a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use».

81 The IFRS IC received a submission about how to assess whether a contract contains a lease when the supplier has particular substitution rights (i.e., specified asset identification). The submitted fact pattern can be summarised as follows:

(a) a customer enters into a 10-year contract with a supplier for the use of 100 similar assets: for example, batteries used in electric buses. The customer uses each battery together with other resources readily available to the customer;

(b) the supplier is required to replace an asset as soon as its capacity is below the minimum amount specified in the contract. At inception of the contract the assets are expected to operate above the specified minimum capacity—without replacement—for eight years. The assets have other use (for example, to store energy) and have an estimated economic life of 15 years; and

(c) the assets are located at the customer's premises. The supplier has the practical ability to substitute alternative assets throughout the 10-year contract term. At inception of the contract, that event is not considered likely to occur in the first three years of the contract.

82 The submitter asked the following two questions:

83 <u>Question 1 - assessing whether the contract contains a lease</u>: what are the implications if the supplier (i) has the practical ability to substitute alternative assets throughout the period of use but (ii) is expected to benefit economically from the exercise of its right to substitute the asset only on the occurrence of events or circumstances that are not considered likely to occur until some time into the contract term?

84 <u>Question 2 – level at which to evaluate whether a contract contains a lease</u>: if a contract is for the use of multiple similar assets, at what level does an entity evaluate whether the supplier's substitution right is substantive—by considering each asset separately or all assets together?

*IFRS IC's tentative agenda decision (November 2022)*

85 In the submitted fact pattern, the IFRS IC (in agreement with the IASB Staff's initial analysis) concluded that there is an identified asset. This is because:

(a) the asset is specified in the contract; and

(b) the supplier's substitution right is not substantive throughout the period of use (as required by paragraph B14 of IFRS 16). This is because the supplier is not expected to benefit economically from the exercise of its right to substitute the asset for at least the first three years in which the asset is used to fulfil the contract with the customer.

86 Furthermore, the IFRS IC concluded that, in the submitted fact pattern, the customer assesses whether the contract contains a lease (including evaluating whether the supplier's substitution right is substantive) for each asset taken individually. The customer does not consider all 100 similar assets as a single unit of account. This is because the customer:

(a) is able to benefit from use of each asset individually together with other resources available to its premises; and

(b) each asset is neither highly dependent on, nor highly interrelated with, the other assets in the contract.

87 The IFRS IC concluded[4] that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate whether, in the submitted fact pattern, the level at which to assess whether the contract contains a lease and whether there is an identified asset. Consequently, the IFRS IC tentatively decide not to add a standard-setting project to the work plan and publish an agenda decision outlining the applicable requirements in IFRS 16 and how a customer applies those requirements in the submitted fact pattern. An agenda Decision was subsequently published on 9 December 2022 and open for comments until 6 February 2023.

*Comment letter summary*

88 15 comment letters were received on the tentative agenda decision by the comment deadline that can be summarised as follows:

<u>Level at which to evaluate whether a contract contains a lease</u>

(a) Eleven respondents commented. Almost all of these respondents agreed with the Committee's analysis and conclusions. One respondent said more information about the fact pattern would be needed to conclude.

<u>Assessing whether the contract contains a lease</u>

(b) Most respondents agreed or did not necessarily disagree with the Committee's analysis and conclusion that, in the fact pattern described in the submission, there is an identified asset. However, many of these respondents:

(i) raised questions about the Committee's technical analysis and conclusion that, in the fact pattern described in the submission, the supplier's substitution rights are not substantive throughout the period of use. In particular, these respondents suggested explaining the Committee's judgement in determining that the condition in paragraph B14(b) of IFRS 16 does not exist throughout the period of use.

(ii) requested other clarifications to the wording in the agenda decision.

(c) Three respondents disagreed with the Committee's analysis and conclusions;

[4] 10 out of 14 IFRS IC members agreed with the conclusion that the contract contains a lease and all members agreed that the unit of account is the single battery.

(d) One respondent said that more information would be needed to conclude whether, in the fact pattern, there is an identified asset; and

(e) Another respondent suggested considering and concluding on whether the contract is, or contains, a lease. In addition, some respondents suggested considering and concluding on the lease term which they say was a question raised in the submission.

*IASB Staff analysis and recommendations*

89 The IASB Staff continued to agree with the IFRS IC that when assessing whether the customer has the right to use an identified asset, it is necessary to consider whether both conditions in paragraph B14 of IFRS 16 exist “throughout the period of use”. However, to address concerns raised by some respondents, the IASB Staff suggested to clarify in the agenda decision that this does not mean at all points throughout that period. A mention is suggested to be added to refer to the illustrative example in paragraph B14(a) of IFRS 16 to explain that the fact that the supplier has the practical ability to substitute alternative assets ‘throughout the period of use’, even if it does not already have alternative assets but could source those assets within a reasonable period of time, illustrates that ‘throughout the period of use’ does not mean every minute of every day within that period.

90 In addition, based on the other comments received (e.g., concluding on whether a contract is or contain a lease, concluding on the lease term), the IASB Staff concluded that it could be helpful to refer in the agenda decision to the requirements an entity would apply when assessing the lease term (that is applying the requirements in paragraphs 18–21 of IFRS 16 to determine the lease term), as was done with respect to the other aspects of the definition of a lease.

91 In particular, the IASB Staff noted that an entity applies the requirements on the definition of a lease in IFRS 16 only in assessing whether a contract contains a lease; those requirements do not affect an entity’s determination of the lease term.

92 The IASB Staff recommended finalising the agenda decision, as published in the IFRS IC Update in November 2022, with changes to the tentative agenda decision as suggested above.

93 This topic will be discussed at the 14-15 March IFRS IC meeting.

## Input to IASB project

*Business Combinations—Disclosures, Goodwill and Impairment*

*Issue and background*

94 This session is a request for input on the IASB Project Business Combinations—Disclosures, Goodwill and Impairment.

95 The IASB is moving forward with the project and is seeking feedback of IFRS IC members on some suggestions respondents to the Discussion Paper had for changes to the impairment test of CGUs containing goodwill. The IASB Staff detailed presentation can be found here.

96 The feedback will help the IASB to consider some of the suggestions further and to decide which ones to prioritise. If the feedback on some of the suggestions may depend on decisions the IASB makes on its preliminary views, for example, on whether to provide relief from the mandatory annual quantitative impairment test, the IASB is asking to highlight such dependencies.

97 The IASB classified the suggested changes to the impairment test as:

(a) the changes that can improve the effectiveness of the impairment test; and

(b) the changes that would reduce cost and complexity.

98 The IASB proposed the below four suggestions to reduce management over-optimism, two to address shielding effect and two to reduce cost and complexity of the impairment test.

*The changes that can improve the effectiveness of the impairment test*

Suggestions to reduce management over-optimism

99 **Suggestion 1**: To disclose a comparison of cash flow forecasts used in impairment tests in prior years with actual cash flows.

100 **Suggestion 2**: To provide additional guidance or illustrative examples on the application of paragraph 33 of IAS 36 about reasonable and supportable assumptions and the most recent financial budgets or forecasts approved by management used in cash flow forecasts.

101 **Suggestion 3**: To disclose in which reportable segments the CGU(s) containing goodwill are included in the year of acquisition and/or in the subsequent periods.

102 **Suggestion 4**: To review the list of indicators of impairment in paragraph 12 of IAS 36[5].

Suggestions to reduce shielding

103 **Suggestion 5**: Allocating goodwill to CGUs for impairment testing

(a) To clarify the reference to 'operating segment' in paragraph 80(b) of IAS 36[6] is not a default but a safeguard to prevent goodwill being tested at too high a level (e.g., at an entity level);

(b) To clarify the requirement in paragraph 80(a) of IAS 36 to allocate goodwill to the lowest level within the entity at which goodwill is monitored for internal management purposes;

(c) When clarifying how to allocate goodwill and what 'monitoring' means in point (b) above, to link the level management monitors the business combination, applying the IASB preliminary views[7], to the requirements in paragraph 80 of IAS 36.

Suggested changes that could reduce cost and complexity of the impairment test

104 **Suggestion 6**: To perform an impairment test based on its previous reporting structure before reallocating goodwill to different CGU(s)[8].

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[5] Paragraph 12 of IAS 36 includes a list of internal and external sources of information an entity should consider in assessing whether there is an indication that an asset may be impaired

[6] Paragraph 80 of IAS 36 says that each unit or group of units to which the goodwill is allocated shall: (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and (b) not be larger than an operating segment as defined by paragraph 5 of IFRS 8 Operating Segments before aggregation.

[7] In September 2022, the IASB tentatively decided to propose adding to IFRS 3 a requirement for an entity to disclose, for 'strategically important' business combinations, information about (i) management's objectives for the business combination; (ii) the metrics and targets management will use to monitor whether those objectives are being met; and (iii) in subsequent periods, the extent to which management's objectives are being met, using those metrics, for as long as management monitors the business combination against its objectives.

[8] Paragraph 87 of IAS 36 says that if an entity reorganises its reporting structure in a way that changes the composition of one or more CGUs to which goodwill has been allocated, the goodwill shall be reallocated to the units affected.

105 **Suggestion 7**: Clarify or amend paragraph 99 of IAS 36[9] in order to make it easier to apply.

106 This topic will be discussed at the 14-15 March IFRS IC meeting.

**Decide project direction**

*Consolidation of a Non-hyperinflationary Subsidiary by a Hyperinflationary Parent*

*Issue*

107 The IFRS Interpretations Committee received a request to clarify the application of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies* in regard to consolidating a non-hyperinflationary economy subsidiary by a hyperinflationary economy parent. In particular the submitter asked to clarify whether the parent applies IAS 29 to restate the current year and comparative amounts presented for its non-hyperinflationary subsidiary so that those amounts would be expressed in terms of the measuring unit current at the end of the reporting period (the reporting date).

108 The submitter identified two existing approaches, as follows:

(a) **View 1**:

(i) the parent does not restate the results and financial position of its non-hyperinflationary subsidiary in terms of the measuring unit current at the reporting date.

(ii) Proponents of this view highlight the requirement in the last sentence of paragraph 35 of IAS 29, which states 'the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21'.

(b) **View 2**:

(i) the parent restates the results and financial position of its non-hyperinflationary subsidiary in terms of the measuring unit current at the reporting date.

(ii) Proponents of this view note that paragraph 1 of IAS 29 includes within the scope of IAS 29 the consolidated financial statements of any entity whose functional currency is that of a hyperinflationary economy and refer to the overall objective and requirements in IAS 29 that require the financial statements to be stated in terms of the measuring unit current at the reporting date.

*IASB Staff Recommendation*

109 The IFRS IC Staff initially concluded that an entity could reasonably read the applicable requirements in IAS 21 and IAS 29 to require - or not require - restatement of the non-hyperinflationary subsidiary in terms of the measuring unit current at the reporting date.

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[9] Paragraph 99 of IAS 36 says that the most recent detailed calculation made in a preceding period of the recoverable amount of a CGU to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met: (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation; (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and (c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

110 They also concluded that the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for an entity to determine the required accounting.

111 The IFRS IC Staff recommended to the IFRS IC that further research and outreach should be conducted to decide whether to add a standard setting project or not. They would like to obtain the following:

(a) Further information on the prevalence of the matter and whether it has (or is expected to have) a material effect on entities affected.

(b) Information about other related matters (if any) with respect to the application of IAS 29.

(c) Information about the feasibility of possible narrow-scope standard-setting and the usefulness of the information provided by those possibilities.

*IFRS IC conclusions (June 2022)*

112 The IFRS IC concluded that, applying the requirements in IAS 21 and IAS 29 to the submitted fact pattern, the parent could restate or not restate the subsidiary's results and financial position in terms of the measuring unit current at the end of the reporting period.

113 The IFRS IC will decide whether to add a standard-setting project to the work plan at a future meeting after considering information to be obtained from further research and outreach on the topic.

**Items for future consideration**

*Merger between a parent and its subsidiary in separate financial statements*

114 The issue – The issue relates to the interpretation of paragraph 9[10] of IAS 27 *Separate Financial Statements*, and clarification on how to account for the merger between a parent and its subsidiary in the separate financial statements of the parent.

115 Opposing views:

(a) **View 1**: The merger is a business combination in separate financial statements

(i) The existing parent-subsidiary relationship, i.e., the parent's control over its subsidiary should be ignored. Given this, the merger meets the definition of 'business combination' in IFRS 3 because IFRS 3 defines 'business combination' as a transaction or other events in which an acquirer obtains control of one or more businesses.

(ii) From the perspective of separate financial statements, a subsidiary's business is deemed to be independent of its parent's business until the two are legally merged.

[10] Paragraph 9 *Separate financial statements shall be prepared in accordance with all applicable IFRSs, except as provided in paragraph 10.*

Paragraph 10 *When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:*

*(a) at cost;*

*(b) in accordance with IFRS 9; or*

*(c) using the equity method as described in IAS 28.The entity shall apply the same accounting for each category of investments. Investments accounted for at cost or using the equity method shall be accounted for in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations when they are classified as held for sale or for distribution (or included in a disposal group that is classified as held for sale or for distribution). The measurement of investments accounted for in accordance with IFRS 9 is not changed in such circumstances.*

(b) **View 2**: The merger is not a business combination in separate financial statements

(i) The parent has already obtained control of the subsidiary before the merger, and the resulting parent-subsidiary relationship should continue to hold even in the context of separate financial statements. Therefore, the merger does not meet the definition of 'business combination' in IFRS 3.

(ii) From the perspective of separate financial statements, a subsidiary's business is deemed to be compressed into its parent's investment in the subsidiary. So, a subsidiary's business should not be viewed as independent of its parent's business.

(c) View 3: The merger may be treated either as a business combination or as another transaction

(i) This view is based on the following reason: since an IFRS that specifically applies to the merger is absent, management should use its judgement to develop an accounting policy that will result in more relevant and reliable information, as stated in paragraph 10 of IAS 8.

**Questions for the EFRAG CFSS and EFRAG FR TEG members**

116 Regarding the IFRS IC topic on Homes and Home Loans Provided to Employees (from paragraph 38 to 41), the IASB Staff indicates that the issue is not common nor is material and limited diversity has been observed. Do EFRAG FR TEG-CFSS members agree with this? Please explain.

117 For the IFRS IC topics that are initially considered, please advise if there are any topics that are prevalent and/or significant? Do you have any other comments on the topics presented?

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