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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 the 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 <small>(including hyperlinks to the IASB project pages for each item)</small>	Related Standards	Current status	Next milestone	Next milestone expected date
Initial consideration				
Payments Contingent on Continued Employment during Handover Periods	IFRS 3	September 2023 IFRS IC meeting	Tentative Agenda Decision feedback	Not specified
Comment letters on tentative agenda decision				
Guarantee over a Derivative Contract	IFRS 9	Tentative Agenda Decision Feedback - September 2023	IASB meeting	Not specified
Premiums Receivable from an Intermediary	IFRS 17 IFRS 9	Tentative Agenda Decision Feedback - September 2023	IASB meeting	Not specified

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Homes and Home Loans Provided to Employees	IAS 19 IFRS 9	Tentative Agenda Decision Feedback - September 2023	IASB meeting	Not specified
Merger between a parent and its subsidiary in separate financial statements *	IAS 27	Consultation ended 14 August	Tentative Agenda Decision Feedback	November 2023

*to be discussed in future EFRAG FR TEG-CFSS meetings

Initial consideration

Payments Contingent on Continued Employment during Handover Periods

Issue and background

- 6 The IFRS IC received a submission about how an entity accounts for payments to the sellers of an acquired business when those payments are contingent on the sellers' continued employment during a post-acquisition handover period. These arrangements are automatically forfeited if employment terminates.
- 7 In most cases, by applying the requirements of paragraph B55(a) of IFRS 3 Business Combinations on the basis of the IFRIC January 2013 Agenda Decision, these arrangements are accounted as compensation for post-combination services rather than additional consideration for an acquisition. The submission describes that the application of the requirements has a material effect on the entity's financial statements (e.g., operating income).
- 8 The submission includes the main reasons on why the accounting outcome does not reflect the economic substance of the transaction:
 - (a) The sellers' duty is only related to providing hand-over services;
 - (b) The sellers are compensated at a level that is comparable to other management executives;
 - (c) There are two components of the contingent payment: the earnout payment and the post-acquisition compensation.
- 9 The IASB Staff has sent a request for information to IFASS members, securities regulators and large accounting firms. 19 responses were received:
 - (a) Most respondents say that fact patterns, as described in the submission are common and can be material for affected entities.
 - (b) All respondents say that entities (generally) apply the accounting described in the January 2013 Agenda Decision.
 - (c) Some respondents disagree with the accounting outcome of the January 2013 Agenda Decision, since in their view it does not always reflect the economic substance of the arrangement.

IASB Staff analysis

- 10 Based on the results from the outreach, and the submitter's statement on current practice, the IASB Staff considered that there is no significant diversity in how entities account for the fact pattern included in the submission. Therefore, they do not consider that the matter satisfies the criteria for adding a standard-setting project to the workplan.

IASB Staff recommendations

- 11 The IASB Staff recommend the IFRS IC not to add a standard-setting project to the workplan but instead publish a tentative agenda decision explaining the reasons the Committee decided not to add a standard-setting project.

Comment letters on tentative agenda decision

Premiums Receivable from an Intermediary

Issue and background

- 12 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.
- 13 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 (i.e., the premiums receivable is within the boundary of an insurance contract and therefore IFRS 17 applies);
 - (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.
- 14 In March 2023, the IFRS IC tentatively concluded that an insurer could account for premiums paid by a policyholder and receivable from an intermediary applying either IFRS 17 or IFRS 9 as IFRS 17 is silent on this issue. Also, the IFRS IC tentatively concluded that a project would not result in an improvement in financial reporting that would be sufficient to outweigh the costs. The IFRS IC therefore decided not to recommend that the IASB considers adding a standard-setting project to its workplan.

Comment letter summary

- 15 16 comment letters were received:
 - (a) 14 respondents agreed with the IFRS IC's conclusion not to recommend that the IASB considers adding a standard-setting project to its workplan;
 - (b) One respondent says, rather than finalising the agenda decision, the Committee needs to reconsider whether to refer the matter to the IASB; and
 - (c) One respondent does not disagree with the Committee's conclusion that the Committee does not refer the matter to the IASB, but says, in their view, only View 2 is the appropriate accounting treatment for the submitted fact pattern.

IASB Staff analysis

- 16 The IASB Staff continue to agree with the IFRS IC's technical analysis in the tentative agenda decision and that an entity is not prohibited from applying either IFRS 17 or IFRS 9. They also continue to agree not to add a standard-setting project.
- 17 The IASB Staff recommend finalising the tentative agenda decision with some changes relating focusing on the key reasons of the technical analysis and some clarifications.

Homes and Home Loans Provided to Employees

Issue and background

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

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- (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
- 19 Following an information request, the IASB Staff concluded that such scenarios are not common, and/or the amounts involved are not material. Moreover, limited diversity has been observed. Consequently, the IASB staff proposed 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.
- 20 The IASB Staff received the feedback on draft agenda decision from seven organisations where:
- (a) Five organisations agreed with the draft agenda decision and provided limited drafting suggestions;
 - (b) Two organisations disagreed with the draft agenda decision and explained that the scenarios are prevailing or material in their jurisdictions.
- 21 Based on the feedback received, the IASB Staff concluded that matters described in the request do not have widespread effect and they do not have (and nor are they expected to have) a material effect on those affected.
- 22 Consequently, the IASB proposes the IFRS IC to finalise the agenda decision with the consideration of the drafting adjustments.

Next steps

- 23 The IASB Staff will consult the IASB at the coming meeting whether they agree or object with the IFRS IC agenda decision.

Guarantee over a Derivative Contract

Issue and background

- 24 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).
- 25 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.
- 26 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?
- 27 In the fact pattern, the submitter outlined different views.
- IFRS IC's tentative agenda decision (March 2023)*
- 28 Based on evidence gathered from the request for information sent to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms, in March 2023 the Committee concluded that the matter described in the request does not have widespread effects and it does not have (and nor is it expected to have) a material effect on those affected. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan.
- 29 The deadline for commenting on the tentative agenda decision was 22 May 2023.
- Comment letter analysis*
- 30 Six comment letters were received by the comment letter deadline of which two were from large accounting firms, and the other four were from national standard-setters. All six respondents agreed with the Committee's decision not to add a standard-setting project onto its work plan for the reasons set out in the tentative agenda decision.
- IASB Staff recommendations*
- 31 Based on the comment letter feedback, the IASB Staff recommends that the Committee finalise the tentative agenda decision as published in the IFRIC Update in March 2023.

Merger between a parent and its subsidiary in separate financial statements

- Issue and background*
- 32 The IFRS IC received a submission about how an entity that prepares separate financial statements applying paragraphs 9-10 of IAS 27 *Separate Financial Statements* accounts for a merger with its subsidiary in its separate financial statements.
- 33 In the submitted fact pattern:
- (a) a parent entity prepares separate financial statements applying IAS 27 and recognises an investment in a subsidiary applying paragraph 10 of IAS 27;
 - (b) the subsidiary contains a business (as defined by IFRS 3 *Business Combinations*); and
 - (c) the parent entity merges with the subsidiary resulting in the subsidiary's business becoming part of the parent entity.
- 34 The submitter asked whether, in the context of the parent entity's separate financial statements, the merger is a business combination as defined by IFRS 3

and consequently, whether the parent should apply the business combination accounting requirements in IFRS 3.

- 35 In the fact pattern, the submitter outlines three different views as follows:
- (a) View 1: the merger is a business combination in separate financial statements - The existing parent-subsidary relationship should be ignored. Given this, the merger meets the definition of 'business combination' in IFRS 3. A subsidiary's business is deemed to be independent of its parent's business until the two are legally merged.
 - (b) View 2: the merger is not a business combination in separate financial statements - The resulting parent-subsidary 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. 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 - 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 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Findings from information requests and additional research

- 36 The IASB Staff sent an information request to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms; 16 responses were received. The findings can be summarised as follows:

Is the fact pattern common?

- 37 Many respondents said that the fact pattern was common. Four standard Setters and one accounting firm said that the fact pattern was not common because: (a) entities do not prepare separate financial statements; (b) entities do not apply IFRS Accounting Standards when preparing separate financial statements; and/or (c) merger transactions as described in the fact pattern occur only occasionally.

If yes, In which jurisdiction(s) is the fact pattern common?

- 38 Respondents said that the fact pattern was common in some countries across Latin America, Africa, Europe and Asia.

How the parent entity accounts for the merger?

- 39 All respondents who said that the fact pattern was common indicated that the carrying amount method (that is, the outcome of applying View 2) was the predominant accounting method used in the separate financial statements. They said that the parent entity controlled the subsidiary before the merger and, consequently, the merger is not a business combination. Two accounting firms said that there might be diversity; however, they have not observed any entity applying View 1.
- 40 A few respondents suggested that the IASB considers this transaction as part of its project on Business Combinations under Common Control (BCUCC project).
- 41 Furthermore, the IASB Staff reviewed annual financial statements filed in the period from 1 January 2020 to 21 April 2023 using a market intelligence tool to identify the accounting policies applied with respect to the submitted fact pattern. As a result, the IASB Staff identified few entities which had merger transactions

similar to the fact pattern described in the submission. The carrying amount method was applied to all of those merger transactions.

IASB Staff analysis and recommendations

- 42 While findings from the IASB's information request indicated that the fact pattern described in the submission could be common, those findings and the additional research showed no evidence of diversity in accounting for the fact pattern. In particular, the existence of the different views described in the submission is not widespread.
- 43 Consequently, the IASB Staff recommended that the Committee did not add a standard-setting project to the work plan and instead published a tentative agenda decision that explains its reasons for not adding a standard-setting project.
- 44 With reference to the interaction with the BCUCC project, the IASB Staff noted that this project aims to develop reporting requirements for business combinations under common control and not to define what is a business combination under common control. The Discussion Paper Business Combinations under Common Control also included within the scope of the project transactions referred to as group restructurings. As Agenda Paper 23A to the IASB's December 2021 meeting notes, a few respondents to the Discussion Paper suggested clarifying whether a 'hive-up' transaction (which is the transaction described in the submission) would be a group restructuring and therefore within the scope of the project. The IASB is currently considering project direction and has not yet discussed whether group restructurings, which could include "hive-up" transactions as described in the submission, will continue to be a part of the BCUCC project. The IASB Staff will report this matter to the IASB when it will deliberate whether to continue to include group restructurings as part of its BCUCC project.

IFRS IC's decision (June 2023)

- 45 Based on its findings, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Questions for EFRAG FR TEG-CFSS

- 46 Does EFRAG FR TEG-CFSS have any comments on the topics presented? Does EFRAG FR TEG-CFSS agree with the IASB Staff outreach result, analysis and recommendations/ IFRS IC's tentative decisions related to the topics presented?
- 47 Does EFRAG FR TEG-CFSS wish to further discuss any of the presented issues at a future meeting?

Next steps

- 48 The EFRAG Secretariat will continue to monitor the IFRS IC's discussions.