IASB potential new research project

Commodity loans and related transactions
Issues Paper

Objective

1 The IASB is currently considering whether to add a project on commodity loans and related transactions to its agenda. To make this decision, the IASB is interested in information about how common those transactions are, whether diversity exists in how they are accounted for, whether any activities in relation to any of these transactions are undertaken in the jurisdictions of TEG-CFSS members and their views on the possible standard setting activity of the IASB. The objective of this session is accordingly to collect the above information from EFRAG TEG and EFRAG CFSS to be shared with the IASB at the April 2018 ASAF meeting.

Background information for EFRAG TEG-CFSS

2 The IFRS Interpretations Committee ('the Committee') received a request on how to account for a commodity loan transaction. The request considered by the Committee described a scenario in which:

(a) Reporting Entity (often a bank) borrows a commodity (gold) from Lender (often another bank) for 12 months (referred to as Transaction #1). On physical receipt of the commodity, legal title passes to Reporting Entity. The commodity is fungible and can easily be replaced with a similar commodity (another bar of gold).

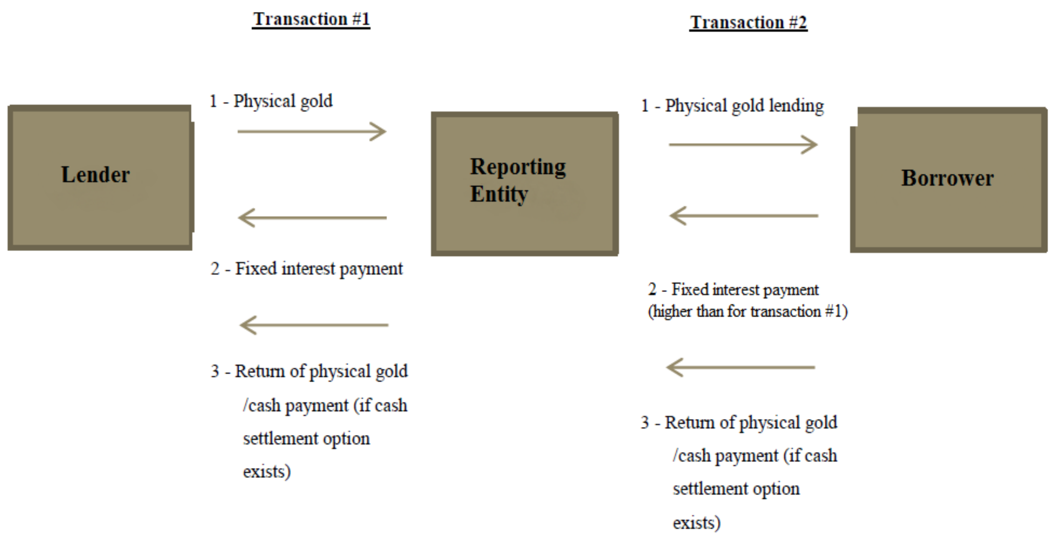
(b) There are no cash inflows or outflows at inception of Transaction #1. Instead, Reporting Entity pays a fixed quarterly fee to Lender for the duration of the contract based on:

(i) the value of the commodity at inception; and

(ii) relevant interest rates at inception.

At maturity, Reporting Entity is obliged to deliver a commodity of the same type, quantity and quality to Lender. Reporting Entity may, or may not, have an option to settle its obligation in cash, on the basis of the spot price of the commodity at maturity.

(c) Reporting Entity then enters into a similar transaction with Borrower (referred to as Transaction #2). In Transaction #2, legal title of the commodity is transferred to Borrower under the same terms and conditions described in Transaction #1, but for a higher fixed fee from Borrower to Reporting Entity.



The diagram above has been taken from the IASB Agenda Paper 12A for the January 2018 IASB meeting.

3 It is assumed that all three parties to the transactions are unrelated to each other. It is also assumed that Reporting Entity negotiates each transaction independently of the other (i.e. Borrower and Lender are unaware of the other's transaction with Reporting Entity), although Reporting Entity is likely to have entered into both transactions in contemplation of the other.

4 The request asked whether Reporting Entity is required to recognise an asset and a liability in respect of these transactions.

The issues

Commodity transactions

5 When discussing feedback from stakeholders, the Committee identified that the transaction described in paragraphs 2 to 3 above and some other commodity transactions might not be captured within the scope of any IFRS Standard.

6 Some of these other commodity transactions which involve liquid commodities being used in a similar way to cash (or other liquid financial assets) are:

(a) Repo-like transactions—For example, an entity buys (sells) a commodity in the spot market and simultaneously enters into a forward contract to sell (buy) the same commodity to the same counterparty at a future date. This may be done through separate trading desks. Some respondents said there is debate about whether an entity accounts for these transactions separately or as one transaction;

(b) Lease and future sale of a commodity using a forward contract—For example, Entity A leases a commodity to Entity B. Entity B concurrently enters into a forward purchase contract to purchase the same amount of the same commodity from Entity A at the end of the lease term. This purchased commodity is then used to return the leased commodity to Entity A. Typically there is no exchange of cash at contract inception but the lessee (Entity B) is required to pay a monthly fee over the lease term;

7 Many entities enter into commodity transactions for financing purposes. For example, some jewellers use commodity lease transactions to obtain gold or silver without an initial outlay of funds. They then use the precious metal to produce jewellery and use the sales proceeds to purchase gold or silver to return at the end of the lease term. Other manufacturers use commodity leasing for similar reasons—e.g. car manufacturers lease palladium (another precious metal) and nuclear power plant operators lease uranium.

8 The outreach activities performed by the Committee also identified other transactions using less liquid commodities, particularly food-based commodities. These include agreements between unrelated entities to swap oilseed or grain inventories to fulfil demand in a particular location. These transactions are not within the scope of IFRS 15, as specified in paragraph 5(d) of that Standard.

9 Commodity-based transactions are also common in Islamic finance.

Other transactions

10 In addition to commodity transactions, the Committee noted that the underlying matter could also be relevant for speculative investments in digital currencies, emissions allowances and some other assets.

Suggestion of the Committee

11 As transactions mentioned above may not be captured by existing IFRS Standards, the Committee suggested that the IASB should determine whether it should add a research project to its agenda. Based on the issues identified above, the scope of a potential project could accordingly include the following transactions:

(a) Transactions involving commodities lending;

(b) Other relevant transactions:

(i) Digital currencies;

(ii) Emission allowances.

Questions for EFRAG CFSS and EFRAG TEG members

12 Are you aware of, and if so to what extend are, entities in your jurisdiction:

(a) holding commodities, digital currencies, emissions allowances or other assets such as artwork for investment purposes; or

(b) using such items in a similar way to cash?

13 Do you know whether there is diversity in accounting for those items?

14 Are any activities relating to the items identified in this paper being undertaken in your jurisdiction?

Possible standard-setting activity

15 The IASB staff has identified two distinct features of the transactions listed in paragraph 11. They accordingly noted that the transactions included in a potential project would involve items that are either:

(a) Used in a similar way to cash (like the transaction submitted to the Committee); or

(b) Held for investment purposes (or held as a store of value for example, gold, artwork or stamp collections).

16 The IASB staff has identified three possible standard-setting activities the IASB or the Committee could undertake to address those transactions:

(a) Prepare a new Investments Standard (similar to IAS 25 *Accounting for Investments* withdrawn in 2001). Such a standard might require measurement at fair value through profit or loss of the assets in the scope of the project except when there is no active market.

(b) Amend the scope of a particular Standard (or Standards) – e.g. IFRS 9 Financial Instruments - to include transactions or items that have specified characteristics.); and

(c) Provide guidance on how to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to help entities to develop accounting policies for transactions that are not within the scope of an IFRS Standard. Such a project might suggest that IAS 40 *Investment Property* deals with similar and related items as those that would be included in the paragraph 15(b) above. IFRS 9 could then be mentioned as a Standard that deals with items similar to highly-liquid assets included in the paragraph 15(a) above.

17 To determine the most appropriate course of action the IASB is considering whether it should work on a narrow-scope project to develop the requirements in a short time frame or whether it should address this topic more holistically.

Questions for EFRAG CFSS and EFRAG TEG members

18 Do you have any comments on the IASB staff's preliminary thinking about possible standard-setting the IASB might undertake?

19 Which of the possible activities described do you think the IASB should explore further or, in contrast, avoid (considering the factors discussed in paragraph 7 above)?