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Project	**Commodity loans and related transactions**
Paper topic	Accounting Standards Advisory Forum feedback

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Introduction

1. In January 2018, the International Accounting Standards Board (Board) discussed commodity loans and related transactions. That discussion followed discussions by the IFRS Interpretations Committee (Committee) about a number of transactions that may not be clearly captured within the scope of any IFRS Standard. These transactions include a specific commodity loan transaction submitted to the Committee, other commodity transactions, digital currencies and some transactions involving emissions allowances. The Committee suggested that the Board consider the feedback on this matter in determining whether to add a project to its agenda.

2. The purpose of this session is to obtain:
   (a) ASAF members' views on the prevalence of the transactions identified by the Committee in their respective jurisdictions or regions;
   (b) information about any activities ASAF members are undertaking in relation to any of these transactions; and
   (c) preliminary feedback on the staff's initial ideas of possible standard-setting activity the Board could undertake.

3. This paper is structured as follows:
   (a) Background information (paragraphs 4–9);
   (b) Transactions (paragraphs 10–39); and

(c) Possible standard-setting activity, including;

   (i) An investments Standard (paragraphs 42–55);

   (ii) Standards-based project: Characteristics of transactions (paragraphs 56–59);

   (iii) IAS 8 project: Characteristics of transactions (paragraphs 60–64).

Background information

4. In March 2017, the Committee published an agenda decision relating to a request about a particular commodity loan transaction (this transaction is explained in paragraphs 33-35 of this paper)[1]. The Committee observed in that agenda decision that the particular transaction might not be clearly captured within the scope of any IFRS Standard.

5. When discussing feedback from stakeholders, the Committee identified other commodity transactions that also might not be captured within the scope of any IFRS Standard. Some Committee members also said in their view the matter is broader than commodity transactions. Related topics identified by Committee members include digital currencies (sometimes referred to as cryptocurrencies).

6. The Board discussed Agenda Paper 12A at its meeting in January 2018. That paper presented a summary of the Committee's discussions and feedback on commodities and the related topics identified as being of potential relevance to the Board in considering any further work to be done.

7. At the January 2018 Board meeting, Board members asked the staff to research:

   (a) whether the transactions that might be in the scope of any standard-setting project are widespread and could have a material effect on IFRS reporters;

   (b) possible narrow-scope standard-setting activities the Board could undertake; and

[1] http://www.ifrs.org/-/media/feature/news/updates/ifrs-ic/2017/ifric-update-march-2017.pdf

(c) whether it might be possible to develop information or requirements based on the application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Such information or requirements would aim to help identify the appropriate IFRS Standard to apply to a transaction that is not covered by a specific Standard based on the characteristics of the particular transaction/item—this is discussed further in paragraphs 60-64 of this paper.

8. The determination of the most appropriate course of action requires consideration of the main driver(s) behind any course of action taken. For example, is it important to develop requirements within a relatively short-time frame and consequently narrow the scope of the matter addressed? Are there particular types of transactions that the Board should address because of their prevalence? Is the most appropriate course of action one that addresses the topic more holistically because any narrower-scope project would involve considerable time and effort in determining scope? We would ask ASAF members to consider these factors in commenting on any possible action that the Board might take.

9. It is also important to note that this paper contains only the preliminary views of the staff, which have not been discussed with, nor do they represent, the views of the Board on this matter. In addition, notwithstanding the research that is being undertaken, one possible outcome is that the Board might decide not to take any further action for these types of transactions at this time.

Transactions

10. In Agenda Paper 12A to the Board's January 2018 meeting, we identified two distinct features of these transactions, namely that they involve items held for investment purposes or items used in a similar way to cash. We have therefore structured this section to first describe transactions that involve items held for investment purposes, and then describe transactions that involve items used in a similar way to cash. We note that for some of the items discussed in this paper, they could be either held for investment purposes or used in a similar way to cash depending on the nature of the transaction.

Items held for investment purposes

11. A number of the transactions identified might be speculative investment transactions—ie an entity may invest in commodities, digital currencies or emissions allowances, even though doing so is not a core component of its business model.

12. Items held for investment purposes might also include items held as a store of value—for example, gold, artwork or stamp collections.

13. ASAF members may also identify other items that entities hold as either speculative investments or as a store of value.

Commodities

14. There are a wide range of transactions involving various types of commodities.

15. In its discussions on commodity loans, the Committee observed that particular IFRS Standards apply to particular types of transactions involving commodities. For example:

    (a) if an entity holds commodities for sale in the ordinary course of business, for use in the process of production or in the form of materials or supplies to be consumed in the production process, it applies IAS 2 *Inventories*.

    (b) commodity broker-traders are permitted to measure commodity inventories at fair value less costs to sell applying paragraph 3(b) of IAS 2.

    (c) an entity applies IFRS 15 *Revenue from Contracts with Customers* to the sale of commodities to customers (unless IFRS 9 *Financial Instruments* applies to the contract).

    (d) an entity applies IFRS 9 to derivative financial instruments that change in value in response to a change in a specified commodity price.

16. However, the Committee also noted that there are other types of transactions involving commodities that might not be captured within the scope of any IFRS Standard.

17. In some cases, commodity transactions are speculative investment transactions—ie entities that are not commodity broker-traders may invest in commodities, even though doing so is not a core component of their business model.

18. In other cases, entities invest in commodities as a store of value. For example, in responding to the Committee's work on commodity loan transactions, some stakeholders said there is debate as to how central banks account for any gold reserves they hold—stakeholders said such reserves have been treated either as a cash equivalent or as an available-for-sale financial asset applying IAS 39 *Financial Instruments: Recognition and Measurement*.

19. We also note that the World Gold Council published a document 'Guidance for Monetary Authorities on the recommended practice in accounting for monetary gold' in February 2018. The World Gold Council notes that IFRS Standards do not include specific requirements for monetary authorities holding gold principally as an element of its foreign exchange reserves (ie what the IMF refers to as 'monetary gold'). That document provides recommendations for monetary authorities to account for monetary gold, as well as a number of other transactions (eg 'non-monetary gold', 'antique gold', 'gold swaps' and 'gold deposits').

20. The Committee also identified other transactions that involve commodities being used for financing purposes and/or in a similar way to cash, which are described in paragraphs 33–39 below.

Digital currencies

21. The ASAF discussed digital currencies at its meeting in December 2016. At that meeting the Australian Accounting Standards Board (AASB) presented Agenda Paper 5.

22. The AASB said digital currencies might meet the definition of an intangible asset in IAS 38 *Intangible Assets* or, if held for sale in the ordinary course of business, would be inventory as defined in IAS 2. However, the AASB questioned whether the measurement outcomes applying either IAS 38 or IAS 2 are appropriate for digital currencies, noting that in its view an entity should generally measure digital currencies at fair value through profit or loss. There is currently no IFRS Standard that permits measurement of intangible assets at fair value through profit

or loss. The AASB therefore suggested that standard setting activity would be required to address this matter.

23. ASAF members did not recommend adding a project on digital currencies to the Board's agenda at that time. However, members suggested that the Board monitor developments in this area.

24. Over the past 15 months, we have therefore monitored press releases, academic journals and other publications on digital currencies. In addition we have noted activities undertaken by a number of national standard-setters and others in particular jurisdictions. For example:

(a) Japan—in March 2018, the ASBJ published a new Standard outlining how to account for digital currencies applying Japanese GAAP. The ASBJ will provide information on this Standard to the ASAF at this meeting.

(b) Canada—the IFRS Discussion Group of the AcSB discussed digital currencies in January 2018, and the AcSB is expected to discuss the topic in the near term.

(c) India—in January 2018, the Institute of Chartered Accountants of India (ICAI) announced that it would conduct a study on accounting and disclosure of digital currencies.

(d) South Korea—in February 2018, the Korea Accounting Institute (KAI) announced that it is in the process of creating an accounting standard for digital currencies.

(e) the US—in July 2017, the FASB received a letter from the Chamber of Digital Commerce about digital currencies.

25. In monitoring activities related to digital currencies, we have noted an increase in the number of Initial Coin Offerings (ICOs) in the second half of 2017. ICOs work by offering to the public a coin or token in exchange for an amount of another digital currency (or, occasionally, cash). We have observed that promises made by entities to investors in ICOs vary. For example, ICOs might promise to deliver to investors:

(a) a new digital currency coin that investors could expect to be able to use widely;

(b) a coin that investors could use to trade goods or services on a market platform being designed by the entity;

(c) a token that investors could use to obtain goods or services directly from the entity in the future; or

(d) a token that entitles investors to a percentage of the entity's future revenue or other cash flows.

26. ICOs raise additional accounting considerations beyond those discussed in this paper, for example how does the issuing entity account for the coins or tokens issued to investors? This paper does not discuss those accounting considerations.

Emissions allowances

27. Many jurisdictions have emissions trading schemes. These schemes are set up to encourage businesses to reduce their greenhouse gas emissions. Under these schemes, the government generally imposes a cap on the quantity of emissions all participants in the schemes can emit and then issues the same quantity of emissions allowances.

28. Entities are able to trade emissions allowances, purchasing (selling) allowances from (to) other entities if they expect their emissions to exceed (be less than) the number of allowances held. Typically, entities will purchase and hold emissions allowances for compliance purposes to ensure they can produce their goods and services.

29. The Board and Committee have previously considered the accounting for emissions allowances used in the ordinary course of business. The Committee issued IFRIC 3 *Emission Rights* in December 2004, which was subsequently withdrawn in June 2005. Research on emissions allowances used in the ordinary course of business is currently part of the Board's research pipeline (the Pollutant Pricing Mechanisms project).

30. We are also aware that some entities invest in emissions allowances solely for speculative investment purposes. Previous discussions by the Board did not address speculative investment by entities in emissions allowances, although

limited research suggests that entities may measure such speculative investments at fair value through profit or loss. If the Board were to consider emissions allowances held for investment purposes as part of any new project, that work would not replace the Board's pipeline research project on Pollutant Pricing Mechanisms. This is because any new project would not capture in its scope the main questions being addressed as part of that research project.

Items used in a similar way to cash

31. The commodity loan transaction submitted to the Committee, and some of the other transactions identified in this paper, involve entities using liquid items in a similar way to cash. Entities structure those transactions so that the liquid item is used as cash might be in similar transactions, and the parties to the transactions are in essence subject to much the same risks as they would be if the transactions were to involve cash. However, if the item is not a financial instrument, the transaction may not be within the scope of IFRS 9 as it would be if the underlying item were cash or another financial instrument.

32. Some of these cash-like transactions involve financial institutions operating as an intermediary between corporate entities. Because of this, any proposed solution may need to consider the accounting applied by both the financial institution intermediary and the corporate entity counterparties.

Commodity loans

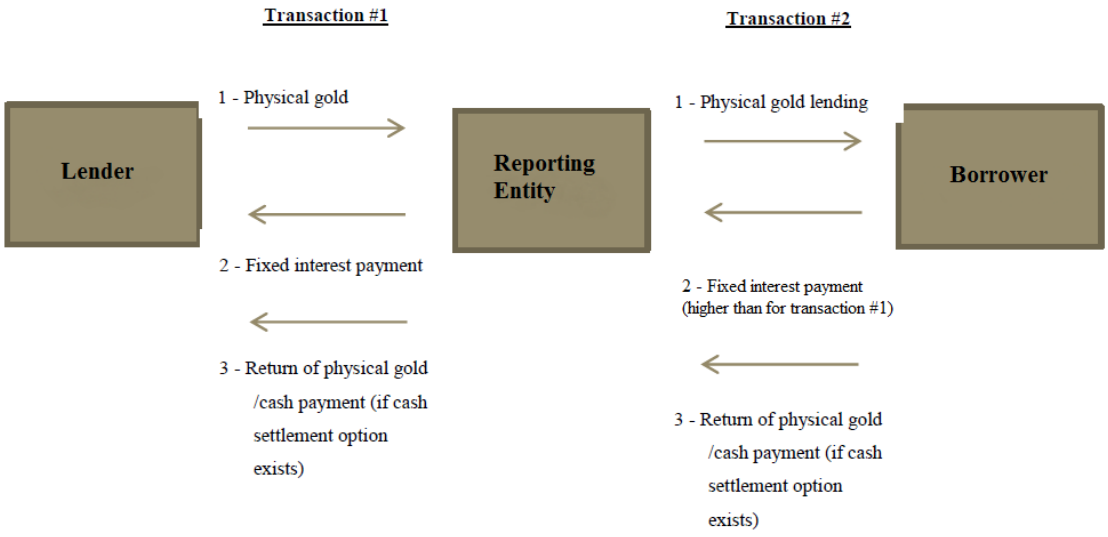
33. The request submitted to the Committee described a scenario in which:

    (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.

34. The following diagram illustrates the transactions.



35. In this scenario, 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 (ie 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.

Other commodity transactions

36. Examples of other transactions identified as part of the Committee's work on commodity loans include:

(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—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.

37. Many entities enter into commodity transactions for financing purposes. For example, respondents said 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—eg car manufacturers lease palladium (another precious metal) and nuclear power plant operators lease uranium.

38. The outreach 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.

39. Commodity-based transactions are also common in Islamic finance. In particular, many Islamic finance banks use commodity murabaha or tawarruq in transacting with customers or for inter-bank liquidity. In these transactions, a bank purchases a liquid commodity (often gold or silver) from a metal broker at a spot price, and sells it to a customer or another bank for a deferred payment amount that is higher than the spot price. The customer then sells the commodity back to the metal broker (often using the originating bank as an agent) at the spot price, obtaining immediate funds. These transactions mimic conventional arrangements entered into by non-Islamic finance banks but avoid charging interest.

Questions 1, 2 and 3 for members of the ASAF

1. 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?

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

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

Possible standard-setting activity

40. We have identified three possible standard-setting activities the Board or Committee could undertake to address some or all of the transactions identified in this paper. These are discussed in the following paragraphs:

    (a) An investments Standard (paragraphs 42–55);

    (b) Standards-based project: Characteristics of transactions (paragraphs 56–59); and

    (c) IAS 8 project: Characteristics of transactions (paragraphs 60–64).

41. Additionally, as noted earlier in this paper the possible actions discussed in this section of the paper represent only the preliminary views of the staff. It is possible that, having considered the additional research undertaken, the Board might decide not to take any further action for these types of transactions at this time.

An investments Standard

42. To address items held for investment purposes, the Board could consider developing a new Standard that is somewhat similar to IAS 25 *Accounting for Investments* before it was withdrawn in 2001. IAS 25 contained requirements for

investments in financial instruments, investment property and other non-financial investments. The new Standard could contain requirements for other non-financial investments.

43. In identifying transactions that such a new standard could address, we think it is helpful to first consider the possible scope of the Standard. If the Board were to undertake such a project, then it would also need to discuss measurement, recognition and derecognition, and disclosure. We briefly describe some of our initial thoughts on these areas below.

Scope

44. In developing the scope of any potential new Standard, the Board would need to define what it considers to be assets held for investment purposes. In doing so, we think the Board could start its deliberation with the definition that was in IAS 25. IAS 25 defined an investment as 'an asset held by an enterprise for the accretion of wealth through distribution (such as interest, royalties, dividends and rentals), for capital appreciation or for other benefits to the investing enterprise such as those obtained through trading relationships.'

45. This is a broad scope and could encompass a large number of assets. The potential new Standard should not include assets that are held for use in an entity's ordinary activities. Accordingly, we think the scope should be restricted to assets held by an entity for capital appreciation or for the accretion of wealth through distribution (such as interest, royalties, dividends and rentals).

46. In addition, we think the scope proposed in paragraph 45 would need to be accompanied by a list of items that the new Standard would exclude from its scope, for example:

(a) Financial instruments within the scope of IFRS 9;

(b) Lease receivables within the scope of IFRS 16 *Leases*;

(c) Inventory within the scope of IAS 2;

(d) PPE within the scope of IAS 16 *Property, Plant and Equipment*; and

(e) Investment property within the scope of IAS 40 *Investment Property*.

47. The scope of IAS 38 acts as a catch-all for intangible assets—ie the Standard applies to intangible assets unless another Standard prescribes the accounting for a specific type of intangible asset. Consequently, we would suggest that the Board consider an amendment to IAS 38 to exclude from its scope intangible assets held for investment purposes.

48. In addition, we think the Board could consider removing the requirements for commodity broker-traders in paragraphs 3(b) and 5 of IAS 2 and, instead, require such entities to apply the new investments Standard.

49. Based on the above, we would expect the potential new Standard to capture within its scope commodities, digital currencies, some emissions allowances and other assets (such as artwork and stamp collections) held for investment purposes.

Measurement

50. Informal outreach to date indicates that a measurement basis of fair value through profit or loss would provide the most useful information to investors about such investments.

51. However, we think there are additional considerations that the Board would need to discuss if it were to undertake a project with this scope. For example, we think it might need to consider items for which there is no active market—we note that, in its standard on digital currencies, the ASBJ requires an entity to measure digital currencies for which there is no active market at cost (or estimated disposal value if that is lower than cost).

Recognition and derecognition

52. Our preliminary thinking is that the recognition and derecognition requirements would be based on the concept of control—ie an entity would recognise an investment when it controls the asset and derecognise it when the entity no longer controls the asset.

Disclosure

53. If the potential Standard were to require measurement at fair value through profit or loss, we think many of the disclosures that investors would find relevant would already be required by IFRS 13 *Fair Value Measurement*.

54. Other possible disclosures to consider would be the amount of income generated from holding such investments and an analysis of investments by category.

55. For some transactions (for example digital currencies), we are aware there is significant volatility in fair value and it might be important to highlight the volatility of such speculative investments. We think the Board could therefore consider requiring entities to provide, for example, information about the range of values during the reporting period together with other disclosures that might highlight the risks associated with those types of assets.

Standards-based project: Characteristics of transactions

56. Another possible standard-setting activity is a project that would define the characteristics of transactions in the scope of particular IFRS Standards. Such a project would result in amending the scope of a particular Standard (or Standards) to include within its scope transactions or items that have specified characteristics.

57. For example, this activity could be used to address some of the transactions that involve entities using highly-liquid assets in a similar way to cash.

58. We would expect the information on such transactions that would be most useful to investors is similar to the information provided on transactions using cash or other highly-liquid financial assets. Consequently, the Board could propose an amendment to IFRS 9 that would include within its scope transactions entered into for financing purposes using highly-liquid items in a similar way to cash.

59. Such a project would focus on defining the characteristics of the transactions to be included within the scope of the Standard. It would also involve some analysis to test the application of all the applicable requirements in the particular Standard to the transactions that would be included within its scope for the first time.

IAS 8 Project: Characteristics of transactions

60. At the Board's January 2018 meeting, some Board members asked us to consider a project that would focus mainly on helping entities to develop accounting policies for transactions that are not within the scope of an IFRS Standard.

61. This project could entail information that would require an entity to:

  (a) identify the particular characteristics of the transaction;

  (b) confirm that the transaction is not within the scope of any IFRS Standard; and

  (c) apply paragraphs 10-12 of IAS 8 in developing an accounting policy for the transaction. The information or requirements that result from this project could then assist the entity in developing its accounting policy. It would do so by 'signposting' or directing the entity to apply to the transaction in question particular requirements in a Standard that deal with similar or related transactions.

62. For example, such a project might suggest that:

  (a) for transactions that involve items held for investment purposes, particular requirements in IAS 40 deal with similar and related items and, thus, the entity should apply those requirements in IAS 40 to the items held for investment purposes.

  (b) for transactions that use highly-liquid assets in a similar way to cash, particular requirements in IFRS 9 deal with similar and related transactions and, thus, the entity should apply those requirements in IFRS 9 to those transactions.

63. Such a project would again focus on defining the characteristics of transactions. It would also again involve some analysis to test the application of the requirements in the particular Standard (eg IAS 40 or IFRS 9) to the transactions considered to be similar or related to those already within the scope of that Standard.

64. If the Board were to undertake this project, we would recommend that it consider incorporating within the project an amendment to the scope of IAS 38. As noted earlier, the scope of IAS 38 acts as a catch-all for intangible assets not within the scope of another Standard. That means, for example, that without any amendment intangible assets held for investment purposes would be within the scope of IAS 38. Work on the project may indicate that the information provided by IAS 38 for such assets held for investment purposes might not provide the most useful information. For example, when the ASAF discussed digital currencies in

December 2016, the AASB noted that in its view an entity should generally measure digital currencies at fair value through profit or loss—this outcome is not possible applying IAS 38. This is also the measurement basis in the ASBJ's standard on digital currencies when an active market exists for the currency.

Questions 4 and 5 for members of the ASAF

4. Do you have any comments on the staff's preliminary thinking about possible standard-setting the Board might undertake?
5. Which of the possible activities described do you think the Board should explore further or, in contrast, avoid (considering the factors discussed in paragraph 8 of this paper)?