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Update on the activity of the IFRS Interpretations Committee

Objective

- 1 The objective of this paper is to provide, for information purposes, a summary of the main open issues discussed by the IFRS Interpretations Committee (the 'IFRS IC').
- 2 The paper focuses on the issues that are still 'open' at the date of the summary, that is, matters that have not yet led to final decision by the IFRS IC.
- 3 The purpose of the presentation is to raise EFRAG 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 TEG's nor EFRAG CFSS's technical assessment on the matters.
- 4 If EFRAG 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

Project (including hyperlinks to the IASB project pages for each item)	Related Standards	Current status	Next milestone	Expected date
Ongoing consultations regarding tentative agenda decisions				
Economic Benefits from Use of a Windfarm	IFRS 16	Consultation on tentative AD until 16 August	Tentative Agenda Decision Feedback	Sep 2021
TLTRO III Transactions	IAS 20, IFRS 9	Consultation on tentative AD until 16 August	Tentative Agenda Decision Feedback	Q4 2021
Tentative Agenda Decision Feedback				
Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition	IAS 32	Consultation on tentative AD ended 24 May	Tentative Agenda Decision Feedback	Sep 2021

Project (including hyperlinks to the IASB project pages for each item)	Related Standards	Current status	Next milestone	Expected date
Non-refundable Value Added Tax on Lease Payments	IFRS 16	Consultation on tentative AD ended 24 May	Tentative Agenda Decision Feedback	Sep 2021
Items for future consideration				
Cash received via an electronic transfer system				Not specified
Demand deposit with restrictions on use	IAS 1/ IAS 7			Not specified
Principal versus agent: IT resellers	IFRS 15			Not specified

Ongoing consultations regarding tentative agenda decisions

Economic Benefits from Use of a Windfarm (IFRS 16)

What is the issue?

- 5 The IFRS IC received a request as to whether a power purchase agreement (PPA) in a gross pool electricity market is, or contains, a lease as defined in IFRS 16 Leases that is whether applying paragraph B9(a) of IFRS 16 Leases, the customer has the right to obtain substantially all the economic benefits from use of an identified asset.
- 6 In the specific submission, a windfarm generator (supplier) enters into a PPA with a customer, both of which are registered participants in a gross pool electricity market.
- 7 The PPA identifies a windfarm owned by the supplier that will be used to supply all the produced electricity to the grid in a gross pool electricity market; over a 20-year period. The customer has agreed to pay a fixed price per megawatt for the volume of electricity produced and supplied by the windfarm over the term of the PPA and is exposed to the price risk.
- 8 In the gross pool electricity market, a market operator determines the spot price for each 30-minute interval during the trading day and calculates for each participant (suppliers and customers) the amount receivable and payable, by applying the relevant spot price to the metered amount for each 30-minute interval.
- 9 The PPA swaps the spot price per megawatt of electricity supplied by the windfarm to the grid for a fixed price per megawatt and is settled net in cash. This means that the supplier receives a fixed price per megawatt for the electricity it supplies to the grid and the customer settles with the supplier the difference between that fixed price and the spot price per megawatt for that volume of electricity.
- 10 The customer also expects to purchase at least the volume of electricity the windfarm produces.
- 11 The PPA also transfers to the customer all renewable energy credits related to the production of electricity by the windfarm.
- 12 The submitter asks IFRS IC to clarify whether the retailer obtains substantially all the economic benefits from the use of the asset (windfarm) as part of the assessment under IFRS 16.

IFRS IC tentative conclusions (June 2021)

- 13 The IFRS IC concluded that, in the fact pattern described in the request, the customer does not have the right to obtain substantially all the economic benefits from use of the windfarm (e.g., the electricity generated). Consequently, the contract does not contain a lease.
- 14 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for a customer that enters into an agreement as described in the request to determine whether it has the right to obtain substantially all the economic benefits from use of an identified asset. Consequently, the IFRS IC [decided] not to add a standard-setting project to the work plan.

TLTRO III Transactions (IFRS 9 and IAS 20)

What is the issue?

- 15 The IFRS IC received a request from the European Securities and Markets Authority on the accounting for the European Central Bank's (ECB) provision of financing to credit institutions under the ECB's third targeted longer-term refinancing operations (TLTROs) programme.
- 16 The amount that banks can borrow under the TLTRO programme is linked to their loans to non-financial corporations and households. By offering banks long-term funding at attractive conditions, they stimulate bank lending to the real economy. Upon meeting certain lending performance thresholds bank can receive loan at reduced interest rates. Also, during 2020, some of the transaction parameters were modified due to disruptions and temporary funding shortages associated with the COVID-19 pandemic.
- 17 Two views are expressed:
 - (a) View 1: TLTRO III transactions are loans at a below-market interest rate and include benefits which are treated as government grants according to IAS 20;
 - (b) View 2: TLTRO III transactions are accounted for as loans at a market interest rate according to IFRS 9.
- 18 ESMA observes a diversity in practice regarding the accounting for a variety of issues that accompany such a transaction (i.e., accounting for below market interest rates using IFRS 9 or IAS 20) and invites the IFRS IC to clarify the applicable requirements.

IFRS IC tentative conclusions (June 2021)

- 19 The IFRS IC concluded that if the bank determines that the TLTRO III tranches contain a government grant in the scope of IAS 20, the requirements in IAS 20 provide an adequate basis for an entity to determine how to account for that government grant.
- 20 With respect to the question of whether conditions attached to the interest rate should be reflected in the estimates and revisions of expected future cash flows when determining the effective interest rate, the IFRS IC concluded that the matters described in the request are part of a broader matter that, in isolation, are not possible to address in a cost-effective manner and should be reported to the IASB Board. The IASB Board should consider this matter as part of the post-implementation review of the classification and measurement requirements in IFRS 9.
- 21 For these reasons, the IFRS IC [decided] not to add a standard-setting project to the work plan.

Tentative Agenda Decision Feedback

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition

What is the issue?

- 22 In the fact pattern a warrant provides the holder with the right to buy a fixed number of equity instruments (of the issuer) for an exercise price that will be fixed at a future date.
- 23 Applying IAS 32.16 at initial recognition, the variability in the exercise price results in the issuer classifying these instruments as financial liabilities. That is, it does not meet the fixed-for-fixed condition. This request asked whether it is possible for the issuer to reclassify a warrant as an equity instrument following the fixing of its exercise price after initial recognition –given that the fixed-for-fixed condition would be met at that stage.

IFRS IC tentative conclusions (March 2021)

- 24 The IFRS IC has tentatively observed that:
- (a) IAS 32 has no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged. Similar questions about reclassifications arise in other circumstances.
 - (b) Reclassification by the issuer was one of the practice issues the IASB will consider in its Financial Instruments with Characteristics of Equity (FICE) project.
 - (c) This specific issue raised is, in isolation, too narrow to address in a cost-effective manner.
- 25 The IASB should consider the matter as part of its discussions on the FICE project.

Non-refundable Value Added Tax on Lease Payments

What is the issue?

- 26 The submission received addresses how to account for non-refundable value-added tax (VAT) charged on lease payment: does a lessee include non-refundable VAT as part of the lease payments for a lease under IFRS 16 Leases?
- 27 In the fact pattern present local VAT legislation requires sellers to collect VAT and remit amounts to the government. In addition, purchasers are generally allowed to recover from the government VAT charged on payments for goods or services, including leases. Because of the nature of the lessee's operations the entity is unable to recover all of the VAT charged on payments it makes for leases.

IFRS IC tentative conclusions (March 2021)

- 28 The IASB Staff conducted limited outreach that indicated that almost all respondents did not include non-refundable VAT as part of the lease payments (as they are not payments to the lessor in exchange for the right to use the underlying asset) and that non-refundable VAT on lease payments is generally not material.
- 29 The IFRS IC has tentatively observed that there is no evidence of diversity in the way lessees account for non-refundable VAT on lease payments.
- 30 The IFRS IC has tentatively concluded that it has not yet obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected.

Items for future consideration

Cash received via an electronic transfer system

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

Fact pattern

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

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

- (a) View A: Yes

There is no accounting standard specific to the timing of recognition of cash in the financial statements. The requirements of IFRS 9 *Financial Instruments* applicable to financial assets are relevant in this matter. IFRS 9:3.1.1-3.1.2 acknowledge that, for the recognition and derecognition of financial assets (e.g., trade receivables), an entity may adopt either a trade date or settlement date policy for regular way transactions as long as the method is applied consistently for all purchases and sales of financial assets that belong to the same category.

- (b) View B: No

The recognition of cash should be based on an assessment of control over the cash (In this case, Entity A does not have control over the cash until received in the bank account). This is consistent with the definition of an asset in the Conceptual Framework, which must be considered in developing an accounting policy applying IAS 8.11(b).

Demand deposit with restrictions on use

- 34 There are diverse views on whether amounts held in a demand deposit should be presented as cash in the statement of financial position and the statement of cash flows when the entity is prevented from using the amounts to meet short-term cash commitments.

Fact pattern

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

- 36 The question raised is: Should the amount be presented as cash and cash equivalents on the statement of financial position (IAS 1:54(i)) and on the statement of cash flows?

- (a) View 1: Yes - The amount meets the definition of cash

As the cash is available on demand and there is no contractual restriction with the bank, it meets the definition of cash in IAS 7:1 i.e., "cash on hand and demand deposits". Consequently, it meets the definition of cash and cash

equivalents for the purposes of presentation in the statement of financial position and the statement of cash flows.

- (b) View 2: No - The amount is neither cash nor cash equivalent

IAS 7:7 is clear that “Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.” Accordingly, if an entity has committed, through the contractual terms of the bank account or via contractual commitments to third parties that are not part of the bank account, that it will not use the amount held in the bank account for meeting short-term commitments then that balance cannot be presented as cash and cash equivalents.

Principal versus agent: IT resellers (IFRS 15)

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

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

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

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

- (a) View 1: The Value-Added Reseller is the Principal

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

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

- (i) The customer benefit only arises from the interaction or combination of the individual promises.
- (ii) From the perspective of the customer, the promise largely represents a single performance (= provision of a suitable and legally secure software solution).
- (iii) The consulting service directly and greatly influences the licence (and vice versa). Thus, consulting risks also give rise to licence risks. The value-added reseller bears the risk for the entire service package and may be held liable accordingly.
- (iv) The consulting thus has a significant impact on the customer benefit.

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

(b) View 2: The Value-Added Reseller is an Agent

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

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

This reasoning can be supported as follows:

- (i) The consulting service of the value-added reseller aims primarily at the software vendor's interest in due licensing.
- (ii) Compared to the value of the standard software licence, the pre-sales consulting overhead and the gross margin usually accounts for a minor share.
- (iii) Pre-sales consulting is provided even in cases in which the sale ultimately does not materialise. Thus, pre-sales consulting services are offered even without remuneration.
- (iv) A customer who knows which contract model would be suitable and how many standard software licences he or she needs would not gain any added value from the pre-sales consulting.

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

Questions for the EFRAG CFSS and EFRAG TEG members

- 42 Do you have any comments on the topics presented?
- 43 Do you wish to further discuss any of the presented issues at a future meeting?