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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 **(including hyperlinks to the IASB project pages for each item)**	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
Initial consideration				
Definition of a Lease: Substitution Rights	IFRS 16	Initial consideration	Consultation	Not specified
Potential annual improvements to IFRS Accounting Standards				
IFRS 1 terminology update	IFRS 1	Initial consideration		Not specified
'de facto agent' assessment (IFRS 10)	IFRS 10	Initial consideration		Not specified
IFRS 9 terminology update	IFRS 9	Initial consideration		Not specified
IAS 7 terminology update	IAS 7	Initial consideration		Not specified
IFRS 7—reference update	IFRS 7	Initial consideration		Not specified

Project **(including hyperlinks to the IASB project pages for each item)**	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
IFRS 7—implementation guidance	IFRS 7	Initial consideration		Not specified
Input to IASB project				
Post-Implementation Review of IFRS 15	IFRS 15	Discussing the objective, activities and the expected timeline	Request for Information	1H 2023
Items for future consideration				
Guarantee over a derivative contract	IFRS 9			Not specified
Homes and home loans provided to employees	IAS 19/ IFRS 9			Not specified
Insurance premiums receivable from an intermediary—submission 1	IFRS 17			Not specified
Insurance premiums receivable from an intermediary—submission 2	IFRS 17			Not specified

Initial consideration

Definition of a Lease: Substitution Rights (IFRS 16)

Issue and background

6 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».

7 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;

(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.

8 The submitter asked the following two questions:

(a) Question 1: 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?

(b) Question 2: 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?

Summary of outreach

9 The IASB Staff sent information requests to members of the International Forum of Accounting Standard-Setters (IFASS), securities regulators, and large accounting firms. In particular:

(a) Regarding Question 1, the request asked members to provide information about whether, in their jurisdictions, fact patterns such as one described in the submission are (or are expected to become) common;

(b) Regarding Question 2, the request asked members whether they are aware of differing views regarding the level at which to evaluate whether a supplier's substitution right is substantive.

10 15 responses were received.

Question 1

11 Most respondents said the submitted fact pattern is not common in their jurisdiction. Two respondents said they have observed similar fact patterns in some jurisdictions (China, Hong Kong, Germany, UK, US). Two other respondents said supplier substitution rights—different from those described in the submitted fact pattern—are generally common in practice.

12 Many respondents said they expect similar fact patterns to emerge in the future because they anticipate:

(a) increasing demand for carbon emission reductions and thus greater use of electric vehicles; or

(b) the inclusion of substitution rights in contracts in an attempt to avoid lease accounting.

13 Some respondents provided examples of industries in which substitution rights are more common. Some also provided examples of the types of assets for which substitution rights are more common.

14 The two respondents that observed fact patterns similar to the one submitted said they have observed diversity in how customers account for such contracts—some account for them as service contracts; others account for them as leases, including when they cannot readily determine whether the supplier has a substantive substitution right (paragraph B19 of IFRS 16).

15 Some respondents said the accounting for contracts with substitution rights may have a material effect on entities' financial statements.

Question 2

16 Some respondents said they were aware of differing views regarding the level at which to assess whether supplier substitution rights are substantive:

(a) some entities apply paragraph B1 of IFRS 16 (portfolio application), because the assets referred to in the contract share similar characteristics. However, some respondents said portfolio application is a practical expedient to apply lease accounting to a portfolio of leases with similar characteristics; it is not applied in assessing whether a contract contains a lease;

(b) some entities apply paragraph B20 of IFRS 16 (portions of assets), because individual assets are physically distinct;

(c) some entities apply paragraph B32 of IFRS 16 (separate lease components).

IASB Staff analysis and Recommendation

17 In the submitted fact pattern, the IASB Staff concluded that there is an identified asset. This is because the asset is specified and the supplier's substitution right is not substantive throughout the period of use (as required by paragraph B14 to conclude that the customer does not have the right to use an identified asset). The facts are such that the supplier would not benefit economically from the exercise of its right to substitute the asset in the first three years in which the asset is used to fulfil the contract with the customer.

18 Furthermore, the IASB Staff concluded that, in the submitted fact pattern, the customer assesses whether the contract contains a lease for each asset, being the customer able to benefit from use of each asset together with other resources available to it and each asset is neither highly dependent on, nor highly interrelated with, the other assets in the contract.

19 The IASB Staff concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate whether, in the submitted fact pattern, there is an identified asset and the level at which to make that evaluation.

20 The IASB Staff recommended that the Committee does not add a standard-setting project to the work plan and, instead, publishes a tentative agenda decision that outlines the applicable requirements in IFRS 16 and how a customer applies those requirements in the submitted fact pattern.

Potential annual improvements to IFRS Accounting Standards

IFRS 1 terminology update

Issue and background

21 The IFRS IC received a submission related to whether the reference in paragraph B6 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* to the "conditions" for hedge accounting in IFRS 9 *Financial Instruments* should be updated to be consistent with the wording in paragraph 6.4.1 of IFRS 9 that refers to "qualifying criteria" for hedge accounting.

IASB Staff's preliminary analysis and views

22 IASB Staff's preliminary view were to:

(a) propose that the IASB amend paragraph B6 of IFRS 1 to replace "conditions" with "qualifying criteria" and amend paragraphs B5–B6 of IFRS 1 to add cross-references to requirements in IFRS 9; and

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

IFRS 10 'de facto agent' assessment

Issue and background

23 The IFRS IC received a submission related to whether to amend paragraphs B74 of IFRS 10 Consolidated Financial Statements to remove the potential inconsistency with the requirements in paragraph B73 related to an investor determining whether another party is acting on its behalf.

IASB Staff's preliminary analysis and views

24 IASB Staff's preliminary view were to:

(a) propose to amend paragraph B74 as follows: "*Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the* *investor has~~, or those that direct the activities of the investor have,~~ the ability to direct that party to act on the investor's behalf. ~~In these circumstances, t~~ The investor shall consider its de facto agent's decision making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee."*

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

IFRS 9 terminology update

Issue and background

25 The IFRS IC received a submission related to whether the reference to the definition of 'transaction price' in Appendix A of IFRS 9 should be removed to avoid potential confusion. Confusion may arise because the term "transaction price" is used in particular paragraphs of IFRS 9 with a meaning that is not necessarily consistent with the definition of that term in IFRS 1.

IASB Staff's preliminary analysis and views

26 The IASB Staff stated that it was evident based on the wording in each respective Accounting Standard that "transaction price" as defined in IFRS 15 is not intended to be, and is not necessarily, the same as "fair value of the consideration given or received". It is also evident in the requirements of IFRS 9 when "transaction price" refers to IFRS 15 and when it does not. In particular, paragraph 5.1.3 of IFRS 9 states that "an entity shall measure trade receivables at their transaction price (as defined in IFRS 15)"'; paragraph 5.1.1 of IFRS 9 states that paragraph 5.1.3 provides an exception from the requirement for an entity to measure, at initial recognition, a financial asset or financial liability at its fair value plus or minus transaction costs (when applicable).

27 IASB Staff's preliminary view were to:

(a) propose to delete the reference to "transaction price" and the associated references to IFRS 15 from Appendix A of IFRS 9;

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

IAS 7 terminology update

Issue and background

28 The Committee received a submission related to whether the term "cost method" used in paragraph 37 of IAS 7 should be updated because it is no longer defined in IFRS Accounting Standards (since May 2008 when the IASB issued "Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate", which amended IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 - *Consolidated and Separate Financial Statements)*.

IASB Staff's preliminary analysis and views

29 IASB Staff's preliminary view were to:

(a) propose to amend paragraph 37 of IAS 7 to replace the term "cost method" with "at cost"; and

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

IFRS 7—reference update

Issue and background

30 The IFRS IC received a submission related to whether paragraph B38 of IFRS 7 - *Financial Instruments: Disclosures* should be updated to remove or replace the reference to paragraph 27A of IFRS 7, which no longer exists (since May 2011 when

the IASB issued IFRS 13 *Fair Value Measurement* and consequently made amendments to several IFRS Accounting Standards*)*.

IASB Staff's preliminary analysis and views

31 IASB Staff's preliminary view were to:

(a) propose to amend paragraph B38 of IFRS 7 to replace the reference to paragraph 27A of IFRS 7 with a reference to paragraphs 72–73 of IFRS 13; and

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

IFRS 7—implementation guidance

Issue and background

32 The IFRS IC received a submission related to whether paragraph IG20C of IFRS 7 should be updated to state that it does not illustrate all the requirements in paragraph 35M of IFRS 7.

IASB Staff's preliminary analysis and views

33 IASB Staff's preliminary view were to:

(a) propose to amend paragraph IG20C of IFRS 7 to add a statement that the example does not illustrate all the requirements in paragraph 35M of IFRS 7; and

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

Input to IASB project

Post-Implementation Review of IFRS 15

Issue and background

34 In September 2022 the IASB started the Post-Implementation Review ("PIR") of IFRS 15 *Revenue from Contracts with Customers*. The issuing of the Request for Information is expected in the 1H 2023.

35 The IASB Staff provided an overview of the PIR objective and process, some background information on IFRS 15 and detailed information on changes introduced by IFRS 15 to support the identification of application matters.

36 The IASB Staff asked to the Committee:

(a) its overall assessment of IFRS 15;

(b) what are the application matters that should be examined during Phase 1 of the PIR by the IASB (the IFRS IC received a presentation to potential issues by the IFRS Staff);

(c) how challenging was the transition to IFRS 15;

(d) if actual costs and benefits arising from the implementation of IFRS 15 differed for those expected in the Basis for Conclusion (Paragraphs BC454–BC493) and if there are other effects of IFRS 15 that should be considered by the IASB in the PIR.

Items for future consideration

Guarantee over a derivative contract

Issue and background

37 A financial guarantee contract ("FGC") 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."

38 A derivative is defined in Appendix A to IFRS 9 as 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 its 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.

39 The submitter asked whether the guarantee contract written by Entity C as described in the fact pattern meet the definition of a FGC? If the definition of a FGC is not met, is the guarantee contract a derivative in the scope of IFRS 9?

40 The submitter proposed the following views:

(a) View A - Yes, the guarantee meets the definition of a FGC;

(b) View B1 – No, the guarantee does not meet the definition of a FGC but it meets the definition of a derivative in the scope of IFRS 9;

(c) View B2 – No, the guarantee does not meet the definition of a FGC and it does not meet the definition of a derivative in the scope of IFRS 9.

41 For further information please refer to the IFRS IC pipeline projects section here.

Homes and home loans provided to employees

Issue and background

42 The IFRS IC received a submission related to the accounting of an arrangement by which an entity provides to its employee the house or a loan for which the employee pays off his share of the cost of the house or the loan principal through deductions from salary over the years of service. The submitter noted some different accounting treatments in practice by applying IFRS 9 or IAS 19.

43 The following questions were submitted:

(a) Question 1: What is the nature of the arrangement during the first 5 years of the employee's participation in the programme? Has the house been transferred on day 1 and, if not, what is the accounting during the initial period?;

(b) Question 2: What is the nature of the arrangement once control of the house has been transferred to the employee? Is it a prepaid short-term employee benefit under IAS 19 or a financial asset under IFRS 9?

(c) Question 3: Does the form of the asset given to the employee (i.e. house or cash) impact the accounting for the programme?

44 For further information please refer to the IFRS IC pipeline projects section here.

Insurance premiums receivable from an intermediary—submission 1

Issue and background

45 Under the general model, insurance contracts are measured as the sum of the fulfilment cash flows and a contractual service margin. The measurement of the fulfilment cash flows comprises "all future cash flows within the boundary of each contract in the group" which would include, to the extent not yet received, "premiums (including premium adjustments and instalment premiums) from a policyholder and

any additional cash flows that result from those premiums" (or 'premiums receivable').

46 When applying the premium allocation approach (PAA), the measurement of the liability for remaining coverage is based on premiums received minus amounts recognised as insurance revenue for services provided, which can also be derived as the sum of the unearned premium applied under existing practice and premiums receivable (IASB PAA educational material).

47 The submitter identified two main approaches:

(a) Apply IFRS 17 to account for premiums receivable in all circumstances; or

(b) Apply IFRS 17 to account for premiums receivable, except premiums receivable via intermediaries once the policyholders have satisfied their obligation to pay premiums by paying the intermediary, in which case IFRS 9 Financial Instruments applies.

48 For further information please refer to the IFRS IC pipeline projects section here.

Insurance premiums receivable from an intermediary—submission 2

Issue and background

49 The submitter noted that there are diverse views on the accounting for insurance contracts when the expected premium cash inflows are receivable via intermediaries which operate between the insurer and the policyholder.

50 The IFRS IC received a submission related to whether the premium due to an insurer from an intermediary should be accounted for under IFRS 17 or IFRS 9. The submission focuses on a scenario where the insurer must fulfil its obligations to the policyholder under the insurance contract because the policyholder has paid the premium to the intermediary.

51 The submitter proposed the following views:

(a) View 1: within the scope of IFRS 17

(b) View 2: within the scope of IFRS 9

52 For further information please refer to the IFRS IC pipeline projects section here.

Questions for the EFRAG CFSS and EFRAG FR TEG members

53 Do you have any comments on the topics presented?

54 Do you agree with the inclusion of these proposed amendments in the next annual improvements cycle (from paragraph 21 to 33)?

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