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Update on the IFRS Interpretations Committee's activities

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 This presentation raises EFRAG FR TEG's and EFRAG CFSS's awareness of 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. EFRAG TEG-CFSS members can also express the need to participate in IASB´s outreach on the topics listed.

Overview of IFRS IC's current activity

5 Below is an overview of the IFRS IC's current activities. When relevant, an oral update of the discussion held at the IFRS IC meeting on 5 March will be provided.

Project/Topic (including hyperlinks to the IASB project pages for each item)	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
Finalisation of agenda decision				
Climate-related Commitments	IAS 37	Tentative Agenda Decision feedback	IASB meeting	Not specified

Project/Topic (including hyperlinks to the IASB project pages for each item)	**Related Standards**	**Current status**	**Next milestone**	**Next milestone expected date**
Payments Contingent on Continued Employment during Handover Periods	IFRS 3	Tentative Agenda Decision feedback	IASB meeting	Not specified
Input to IASB				
Post-implementation Review of IFRS 9 *Financial Instruments*—Impairment	IFRS 9	March 2024 IFRS IC meeting	IASB meeting	Not specified
IFRS IC pipeline				
Classification of Cash Flows related to Margin Calls	IAS 7	Project pipeline	Not specified	Not specified

Finalisation of agenda decision

Climate-related Commitments

Issue and background

6 The IFRS IC received a submission seeking clarification on how to apply IAS 37 Provisions, Contingent Liabilities and Contingent Assets to climate-related risks and related commitments (e.g., “Net Zero transition commitments”).

7 The Committee considered a fact pattern that included two types of commitment:

(a) an emissions reduction commitment—to reduce the entity’s greenhouse gas emissions by a specified amount by a specified future date (from 20X0 to 20X9); and

(b) an offset commitment—to offset the entity’s residual greenhouse gas emissions after that future date (in 20X9 and thereafter) by purchasing and retiring carbon credits.

8 The submitter asked three questions:

(a) Question 1 - does the public statement of a net zero transition commitment create a constructive obligation as defined in IAS 37?

(b) Question 2 - does a constructive obligation created by a net zero transition commitment meet the criteria in IAS 37 for recognising a provision?

(c) Question 3 - if a provision is recognised, is the expenditure required to settle it recognised as an asset or as an expense when the provision is recognised?

9 In addition to the questions above, the IASB staff discussed other accounting consequences of such a commitment (i.e., potential impacts to be reflected in accordance with other IFRS Accounting Standards).

IFRS IC tentative decision (November 2023)

10 The IASB staff clarified that:

(a) A net zero transition commitment does not necessarily create a constructive obligation; indeed, entity's management would need to judge whether such a commitment has created a valid expectation in the public at large as required by IAS 37.20.

(b) the entity has not a present obligation for the following reasons:

(i) all the costs of modifying its manufacturing methods and of purchasing carbon credits need to be incurred to operate in the future and, therefore, when an entity publishes it net zero transition commitment in 20X0 they do not exist independently of the entity's future actions;

(ii) The entity will at some point incur a present obligation to pay for resources it purchases to modifying its manufacturing methods (e.g., new plant or equipment) but only when it receives those resources; and

(iii) The entity will have a present obligation to purchase carbon credits only if and when it emits greenhouse gases in 20X9 and later year.

11 Based on the above, the Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine:

(a) the circumstances in which an entity recognises a provision for the costs of fulfilling a commitment to reduce or offset its greenhouse gas emissions; and

(b) if a provision is recognised, whether the costs are recognised as an expense or as an asset when the provision is recognised.

12 Consequently, the Committee decided not to add a standard-setting project to the work plan.

Comment letter analysis

13 The Committee received 43 comment letters, including 14 from national standard setters (some of them from Europe), 10 from accounting practitioners and 6 from organisations involved in sustainability reporting.

14 Most commentators agree with both the Committee's conclusions and its tentative decision. In particular:

(a) Many of these commentators say they welcome the clarification that the agenda decision will provide.

(b) Some commentators specifically welcome the discussion on identifying constructive obligations, the first step in deciding whether to recognise a provision.

(c) Some commentators specifically welcome the clarification of the past event that gives rise to a present obligation.

15 Four commentators, although not disagreeing with the Committee's technical analysis and conclusions, state or imply that they disagree with the Committee's tentative decision not to add a standard-setting project to the workplan. In particular:

(a) Two of them would like IFRS Accounting Standards to be amended to require entities to recognise provisions for the future costs of fulfilling net zero transition commitments.

(b) One of them would like specific requirements for climate-related matters to be added to IFRS Accounting Standards to promote consistent application and better explain the relationship between the requirements of IFRS Accounting Standards and those of IFRS Sustainability Standards.

(c) Another was of the view that current accounting standards are as clear as they could be and that a conclusion that no provision is required would indicate that current accounting standard are not sufficient.

16 One individual though that the tentative agenda decision should not be issued on its own—it should be issued as part of a more comprehensive response to the accounting implications of climate-related commitments, including impairment of assets.

17 Furthermore, many commentors suggested refinements to the content or the wording of the agenda decision as follows:

(a) add guidance on factors to consider in judging whether a net zero transition commitment creates a constructive obligation – the IASB staff concluded that such additional guidance could be discussed as part if the IASB project on Provisions – Targeted Amendments;

(b) avoid unintended messages on accounting for carbon credits – the IASB staff proposed minor wording changes as it is not the purpose of this agenda decision conclude on the accounting treatment of carbon credits;

(c) omit some analysis of the probable outflows recognition criterion – the IASB staff was of the view that although IAS 37 does not explicitly define the term outflow to mean a net outflow, the requirement for a net outflow is implicit in IAS 37. Therefore, the IASB staff suggested that the agenda decision retains this aspect of the analysis;

(d) clarify whether and how to analogise to asset decommissioning obligations – the IASB staff concluded that IAS 37 is clear that an entity recognises a decommissioning provision only for the costs of rectifying past damage and not for the costs of rectifying further environmental damage that might result from future use of the asset. The IASB staff will consider opportunities to use the analogy in any educational or communications materials to be developed supporting the agenda decision;

(e) refer to disclosure requirements – the IASB staff suggested that the agenda decision does not refer to possible disclosure requirements relating to net zero transition commitments. Indeed, IAS 37 has no specific requirement in this respect and the general disclosure requirements in IAS 1 depend on the relevant facts and circumstances;

(f) include examples of other accounting implications of a net zero transition commitment – the IASB staff concluded that explaining all the other accounting implications is beyond the scope of the agenda decision and highlighting a few could imply that others are less important; and

(g) other minor drafting amendments.

18 Some respondents included comments on climate-related accounting matters outside the scope of the agenda decision, including:

(a) call for further guidance and educational material, which could be considered as part of the IASB project Climate-related and Other Uncertainties in the Financial Statements;

(b) proposed amendments to IAS 37 (e.g., additional disclosure, application guidance and illustrative examples, guidance on factors give rise to a constructive obligation;

(c) importance of the connectivity between financial and sustainability reporting (i.e., collaboration between the IASB and the ISSB).

19 During the comment period the Committee received a second submission where the submitters:

(a) explained what they regard as limitations of the fact pattern described in the tentative agenda decision (e.g., too simply and not-realistic fact pattern); and

(b) described two other fact patterns, which described an emissions reduction commitment similar to that described in the tentative agenda decision, but with additional information about various actions the entity has taken that affirm its intention to fulfil its commitment;

(c) concluded that:

(i) the entity's statement of its emissions reduction commitment creates a present constructive obligation (or in some circumstances a present legal obligation) to fulfil the commitment; and

(ii) the entity should default to recognising a provision for that obligation when it announces its commitment; and

(iii) if management concludes that an entity's net zero transition commitment does not meet the criteria for recognising a provision, the entity discloses the information required by IAS 37 for contingent liabilities.

IASB Staff analysis and recommendations

Original submission

20 Based on the above, the IASB staff recommended that the Committee finalise the agenda decision, with some wording changes to address the comments received (the revised wording can be found in the Appendix of the AP2 IFRIC March 2024).

Second submission

21 The IASB staff acknowledged that actions an entity takes that publicly affirm its net zero transition commitment could increase the likelihood that the entity has a constructive obligation to fulfil the commitment. However:

(a) whether a statement of a net zero transition commitment gives rise to a constructive obligation as defined in IAS 37 depends on the facts of the commitment and the circumstances surrounding it. It cannot be assumed that an entity that has taken the actions described in the fact patterns in the second submission necessarily has a constructive obligation.

(b) neither making a statement of a net zero transition commitment nor taking other actions that affirm an intention to fulfil the commitment are the past events that give rise to a present obligation. For this reason, those actions are not sufficient to meet the criteria in IAS 37 for recognising a provision or disclosing a contingent liability—the entity must also have taken the actions to which the commitment applies, for example, emitted greenhouse gases it has committed to offset.

22 Based on the above, the IASB staff concluded that the features of the fact patterns described in the second submission:

(a) do not raise technical issues beyond those addressed in the tentative agenda decision; and

(b) do not affect the conclusions set out in the tentative agenda decision.

23 Hence, the IASB staff concluded that the second submission warrants neither a second agenda decision nor re-exposure of the tentative agenda decision published in December 2023. However, the Committee proposed to address some of the limitations raised by the submitter clarifying in its Tentative Agenda Decision that:

(a) if the transition plan changes in overtime, an entity has to update also its conclusion about the constructive obligation; and

(b) difference in timing between the entity's public statement and the issuance of the detailed transition plan and the presence of multiple intermediate targets would not change entity's assessment.

Payments Contingent on Continued Employment during Handover Periods

Issue and background

24 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.

25 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).

26 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.

27 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 said that fact patterns, as described in the submission are common and can be material for affected entities.

(b) All respondents said that entities (generally) apply the accounting described in the January 2013 Agenda Decision.

(c) Some respondents disagreed 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 and recommendations

28 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.

29 The IASB Staff recommended the IFRS IC not to add a standard-setting project to the workplan but instead publish a tentative agenda decision explaining the reasons for not adding a standard-setting project.

IFRS IC tentative decision (September 2023)

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

Comment letter analysis

31 The Committee received 11 comment letters on the tentative decision.

(a) Most respondents agreed with the Committee's tentative decision.

(b) However, some respondents consider paragraph B55(a) of IFRS 3 being 'rules-based'. As a result of the language used, the application of this paragraph may result in outcomes that do not faithfully reflect the economic substance of the arrangement in some cases (please refer to the examples in paragraph 15 of AP3 IFRIC March 2024).

(c) These respondents considered that paragraph B55(a) should be an indicator an entity considers, rather than being conclusive that the arrangement is remuneration for post-combination services.

(d) In addition, respondents provided comments on other matters including:

(i) What constitutes employment termination;

(ii) The accounting when there is early employment termination; and

(iii) How to assess whether a service condition is not substantive.

IASB Staff analysis and recommendations

32 The IASB staff continued to consider that there is no significant diversity in how entities account for the fact pattern included in the submission, and did not consider that it satisfies the criteria for adding a standard-setting project to the workplan.

33 Concerning the comments received on other matters, the IASB staff considered that these questions would go beyond the scope of the submission and therefore did not recommend any changes.

34 Therefore, the IASB staff recommended finalising the agenda decision (the proposed wording can be found in Appendix A of AP3 IFRIC March 2024).

Input to IASB

Post-implementation Review of IFRS 9 Financial Instruments—Impairment

Issue and background

35 The IFRS IC received a request for input to the IASB's post-implementation review (PIR) of impairment requirements in IFRS 9. Specifically, the following implementation matters related to determining expected credit losses (ECL) were of interest:

(a) Intragroup financial instruments (Topic 1);

(b) Loan Commitments (Topic 2);

(c) Financial Guarantee contracts (Topic 3); and

(d) Purchased or originated credit-impaired (POCI) financial assets (Topic 4).

36 For each of the matters listed, the overall assessment is required:

(a) Whether the matter is pervasive;

(b) Whether the matter has substantial consequences; and

(c) What is the root cause for the matter.

Topic 1 – Intragroup financial instruments

PIR feedback

37 In the view of some respondents, the costs of applying the general approach to intragroup financial instruments, such as loans and receivables or financial guarantee contracts, exceed the benefits of the resulting information. The key reasons are (both concerning costs of determining significant increases in credit risk (SICR) or measuring ECL): lack of appropriate information for existing ECL models; lack of historical experience or future expectations for credit losses.

38 The general approach may also lead to counterintuitive results as it does not capture subjective or qualitative factors inherent in such transactions, notably financial support from the parent and the group entities.

39 The stakeholders suggested to extend the scope of the simplified approach under IFRS 9 to these instruments or to exclude them from scope of IFRS 9 (similarly to US GAAP).

IASB staff analysis

40 In the view of the IASB staff, the general ECL approach might, indeed, need to be adjusted by the entity to tailor it to the characteristics of intragroup instruments and availability of data. Doing so is both required and allowed by the existing principle-based requirements of IFRS 9.

41 Both the assessment of SICR and the measurement of ECL are required to be based on reasonable and supportable information that is available to an entity without undue cost or effort. Qualitative information and using practical expedients may replace more complex techniques as long as the result reflects the entity's actual expectations about credit losses on intragroup instruments.

42 At its February 2024 meeting, the IASB tentatively decided not to undertake standard-setting actions on this matter.

Committee members' input

43 In the view of the committee members, IFRS 9 provides an adequate basis for determining ECL for intragroup instruments. Applying the general ECL approach mechanically would be inconsistent with the requirements of IFRS 9 and might also contribute to high application costs.

Topic 2 – Loan commitments

PIR Feedback

44 Lack of definition for loan commitments. PIR respondents referred to lack of definition for loan commitments which, in their view, leads to application issues (e.g., a commitment to enter into a convertible bond). Therefore, they proposed to add such a definition. The IASB staff noted that PIR feedback does not provide evidence that substantial consequences arise in practice, given that the issues referred to in the PIR feedback may be addressed by the existing requirements of IFRS 9.

45 Period over which to estimate ECL for individually managed instruments. PIR respondents suggested that the IASB clarifies the scope of the exception in paragraph 5.5.20 of IFRS 9—specifically, whether facilities, such as corporate overdrafts, that are managed on an individual basis are outside the scope of this exception and, thus, their ECL is required to be measured over the maximum contractual period. The IASB staff replied that the exception was designed to address specific concerns and that PIR feedback did not indicate whether stakeholders are unclear about the accounting outcome in accordance with IFRS 9 or whether they consider that outcome to be inadequate.

Topic 3 – Financial guarantee contracts

PIR Feedback

46 Credit enhancement in the measurement of ECL. PIR respondents suggested that the IASB adds application guidance for determining the credit enhancements that are considered ‘part of’ / ‘integral to’ the contractual terms for the purposes of measuring ECL applying paragraph B5.5.55 of IFRS 9. The IASB staff noted that in order to undertake standard-setting activities, the IASB would need evidence that incremental benefits of such activities would outweigh costs.

47 Accounting for premiums received over time for financial guarantees issued. PIR respondents noted that paragraph 4.2.1(c) of IFRS 9 or the related requirements are not sufficiently clear for entities to determine the accounting outcome for financial guarantee contracts for which the premiums are received over time, rather than upfront which results in diversity in practice. The IASB staff noted that the IASB would need to consider whether such diversity results in substantial consequences and, if yes, why?

Topic 4 – POCI financial assets

PIR Feedback

48 PIR respondents noted that diversity in practice was reported on the accounting for decreases in credit risk since initial recognition—specifically, some entities adjust the gross carrying amount of a POCI financial asset, others recognise it as a negative entry to the ECL allowance. The IASB staff noted that this feedback does not suggest that it results in substantial consequences in practice.

IFRS IC pipeline

Classification of Cash Flows related to Margin Calls (IAS 7)

Issue and background

49 The submitter has observed different views on the application of the requirements of IAS 7 *Statement of Cash Flows* in relation to the presentation of cash flows from margin calls for certain contracts to purchase or sell commodities at a predetermined price at a specified time in the future.

50 The submitter has observed that some entities:

(a) Over the life of the contracts, some entities present all cash flows related to margin calls within cash flows from financing activities in their statements of cash flows, regardless of the reason for which the contract was entered into (e.g., own-use contracts, hedging of the exposure to fluctuations in commodity prices, trading purposes), while other entities present those cash flows within cash flows from operating activities.

(b) On the settlement date of the contract, entities that classify margin call cash flows as financing activities present the settlement payment as cash flows from operating activities. In addition, at the same time, they eliminate the cumulative amount of cash flows from margin calls for the settled contract previously classified as financing cash flows from the cash flows from financing activities and add this amount to cash flows from operating activities. As a consequence, cash flows from operating activities do not reflect the volatility stemming from the fair value changes during the life of the contracts.

51 The submitter seeks clarification on whether the cash flows resulting from margin calls for contracts (paragraph 50(a) above) should be classified as cash flows from operating activities or whether another classification (i.e., as cash flows from financing activities) is compliant with the requirements of IAS 7.

Questions for EFRAG FR TEG-CFSS

52 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?

53 Does EFRAG FR TEG-CFSS wish to further discuss any of the presented issues at a future meeting?

Next steps

54 The EFRAG Secretariat will continue to monitor the IFRS IC’s discussions.