IFRS

STAFF PAPER

March 2017

IFRS® Interpretations Committee Meeting

Project	Commodities		
Paper topic	Commodity loans		
CONTACT	Kathryn Donkersley	kdonkersley@ifrs.org	+44 (0)20 7246 6970

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for commodity loan transactions. Specifically, the Committee was asked to consider a fact pattern in which an entity borrows a commodity from another entity, and separately lends the same commodity to a third entity for the same period and for a higher fee.

2. The submitter describes a scenario in which:

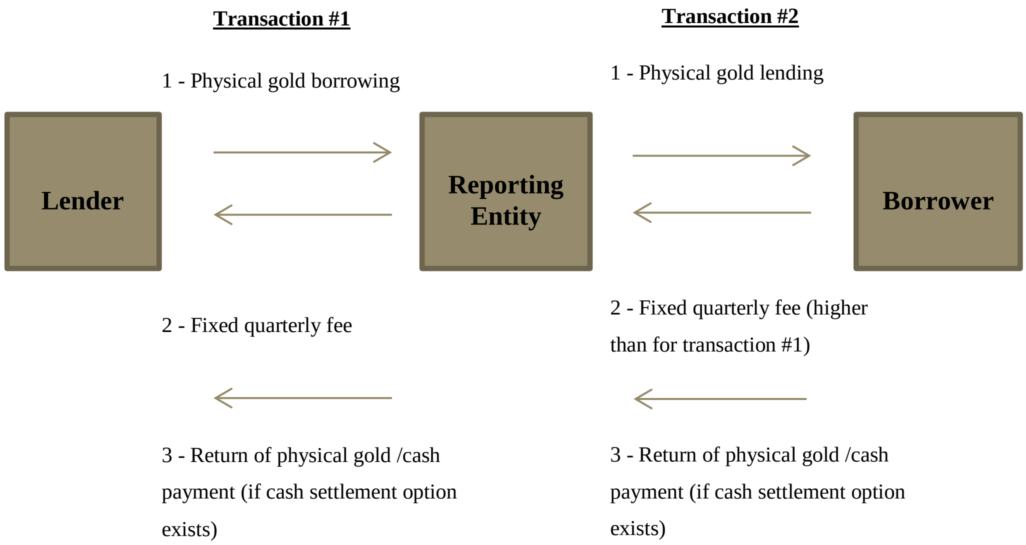
   (a) *Reporting Entity* (often a bank) borrows a commodity (gold[1]) from *Lender* (often another bank) for 12 months (referred to as Transaction #1). On physical receipt of the commodity, legal title passes to Reporting Entity. The commodity is fungible and can easily be replaced with a similar commodity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

[1] The fact pattern described in the submission is a gold transaction. The issue identified could involve other commodities. Thus the term 'commodity' is used throughout this paper, unless we are referring specifically to gold.

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.



3. The submitter asks whether Reporting Entity is required to recognise an asset and a liability in respect of these transactions.

4. The Committee observed that the particular transaction in the submission might not be clearly captured within the scope of any IFRS Standard. In the absence of a Standard that specifically applies to a transaction, an entity applies paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy to the transaction. In doing so, paragraph 11 of IAS 8 requires an entity to consider:

(a) whether there are requirements in IFRS Standards dealing with similar and related issues; and, if not;

(b) how to account for the transaction applying the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*.

5. The Committee noted that, applying paragraph 10 of IAS 8, the accounting policy developed must result in information that is (i) relevant to the economic decision-making needs of users; and (ii) reliable—ie represents faithfully the financial position, financial performance and cash flows of the entity; reflects the economic substance; and is neutral, prudent and complete in all material respects. The Committee also observed that, in considering requirements that deal with similar and related issues, an entity considers all of the requirements dealing with those similar and related issues, including relevant disclosure requirements.

6. The Committee concluded that it would be unable to resolve the question asked efficiently within the confines of existing IFRS Standards. The wide range of transactions involving commodities means that any narrow-scope standard-setting activity would be of limited benefit to entities and would have a high risk of unintended consequences. Consequently, the Committee tentatively decided not to add this issue to its agenda.

7. The purpose of this paper is:

(a) to provide the Committee with an analysis of the comments on the tentative agenda decision; and

(b) to ask the Committee whether it agrees with the staff recommendation to finalise the agenda decision.

Comment letter summary

8. We received five comment letters, which have been reproduced in Appendix B to this paper. Comment letters were received from the South African Institute of Chartered Accountants (SAICA), the Accounting Standards Committee of Germany (ASCG), Ernst & Young Global Limited (EY), Organismo Italiano di Contabilità (The Italian Standard Setter; “OIC”), and Deloitte Touch Tohmatsu Limited (Deloitte).

9. All five respondents agreed with the Committee's conclusion that the transaction described in the submission might not be clearly captured within the scope of any existing IFRS Standard. All five respondents also acknowledged that any narrow-scope standard setting activity in response to the issue would be of limited benefit and/or that the Committee would be unable to resolve the issue efficiently within the confines of existing IFRS Standards.

10. Nonetheless, all respondents had some concerns about the tentative agenda decision. Concerns expressed by respondents were as follows:

    (a) existing requirements in IFRS Standards do not provide an adequate basis for entities to develop an accounting policy on this topic. In particular, respondents thought that:

        (i) the general requirements in IAS 8 are not helpful in the absence of guidance about how to apply those principles to the transaction described in the submission; and

        (ii) there are insufficient requirements in IFRS Standards about commodity accounting more generally.

    (b) the identified diversity in practice will not be addressed. One respondent (Deloitte) further observed that the gap in literature noted in the tentative agenda decision is becoming more problematic as transactions settled in commodities become more common and varied.

11. Although acknowledging the Committee's rationale for its agenda decision, respondents thought that the Board or the Committee should address the diversity in practice, and that the agenda decision would not do this. Suggestions made by respondents were as follows:

    (a) Three respondents (SAICA, OIC and Deloitte) suggested the issue would be best addressed by the Board as part of a broader project. These respondents recommended that the Committee refer the issue to the Board for further consideration. SAICA also suggested that the Committee modify the tentative agenda decision to provide additional guidance in the interim.

(b) ASCG suggested that the Committee provide answers on basic aspects of the issue, such as the recognition of both an asset and a liability and, therefore, reconsider the wording of the tentative agenda decision.

(c) EY suggested either the Board or the Committee should provide guidance on the issue.

12. Our analysis of the concerns raised and suggestions made by respondents is outlined below.

Staff analysis

Concerns about existing requirements in IFRS Standards

13. We note the concerns that existing requirements in IFRS Standards do not provide an adequate basis for entities to develop an accounting policy for the transaction described in the submission. We also note the comments made that these concerns are evidenced by (a) diversity in practice (see paragraphs 18-20 below); and (b) the fact that the Committee is unable to provide an answer for the particular transaction in the submission (ASCG).

14. At its November 2016 meeting, the Committee did not conclude upon how the entity in question accounts for the transaction in the submission. We note, however, that the Committee did provide a framework within the tentative agenda decision to explain how an entity develops an accounting policy for the transaction, reflecting the requirements in IAS 8. Accordingly, any particular entity is able to determine how to account for the transaction applying IFRS Standards. The existing requirements in IAS 8 provide a framework for doing so.

15. When developing an accounting policy, that framework in IAS 8 requires an entity to consider the requirements in IFRS Standards dealing with similar and related issues, and also says that the accounting policy must result in information that is relevant and reliable. An entity, therefore, develops an accounting policy for the transaction in the context of its own particular circumstances. Accordingly, it is not possible for the Committee to explain how all entities would account for the transaction, even though any particular entity itself is able to determine how to do so.

16. The Committee's decision also reflects the high risk of unintended consequences that might arise from reaching a conclusion in this case. In particular, there is a risk that any narrow scope conclusion could be inappropriately applied more broadly to transactions that are similar to, but not the same as, the transaction described in the submission.

17. For these reasons, we think that the tentative agenda decision cannot go further in terms of providing guidance without creating the risk of unintended consequences. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about existing requirements in IFRS Standards.

Concerns about diversity in practice

18. Respondents' concerns about diversity in practice are consistent with the outreach performed on this topic and described in Agenda Paper 10 to the November 2016 Committee meeting. At that meeting, the Committee noted that diversity but nonetheless concluded that the issue does not meet the criteria to be added to the Committee's agenda for the reasons described above.

19. We continue to agree with the Committee's conclusions in this regard. Furthermore, respondents noting concerns about diversity in practice have not provided any new information beyond that considered by the Committee when reaching its tentative agenda decision.

20. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about diversity in practice.

Suggestions made by respondents

The Committee

21. SAICA and ASCG both recommended that the Committee include additional guidance in the tentative agenda decision. However, the staff do not recommend this approach for the reasons described above.

22. We also continue to recommend that the Committee does not add this issue to its agenda. This is because it does not meet the Committee's agenda criteria.

The Board

23. Three of the five respondents (SAICA, OIC and Deloitte) suggested that the issue would be best addressed by the Board as part of a broader project. In addition, EY suggested that either the Board or the Committee should address the issue.

24. We understand the rationale for these suggestions and think that rationale is consistent with the Committee's conclusions at its November 2016 meeting – ie there is identified diversity in practice but any narrow scope standard-setting activity would be of limited benefit and carry a high risk of unintended consequences. Although a broader scope project is outside the remit of the Committee, the Board could consider undertaking such a project.

25. In the light of the feedback received, and consistent with the discussions held by the Committee in November 2016, we will report this issue to the Board at a future Board meeting. The Board will then decide whether to add a project to address the issue, assessing its priority relative to other projects.

Staff recommendation

26. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in IFRIC Update in November 2016 with no substantial changes. Appendix A to this paper outlines the draft wording of the final agenda decision.

Question for the Committee
Does the Committee agree with the staff recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Finalisation of agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through)

Commodity loans

The IFRS Interpretations Committee (the Committee) received a request regarding how to account for a commodity loan transaction. Specifically, the transaction is one in which a bank borrows gold from a third party (Contract 1) and then lends that gold to a different third party for the same term and for a higher fee (Contract 2). The bank enters into the two contracts in contemplation of each other, but the contracts are not linked—ie the bank negotiates the contracts independently of each other. In each contract, the borrower obtains legal title to the gold at inception and has an obligation to return, at the end of the contract, gold of the same quality and quantity as that received. In exchange for the loan of gold, each borrower pays a fee to the respective lender over the term of the contract, but there are no cash flows at inception of the contract.

The ~~Interpretations~~ Committee was asked whether, for the term of the two contracts, the bank that borrows and then lends the gold recognises:

a. an asset representing the gold (or the right to receive gold); and

b. a liability representing the obligation to deliver gold.

The ~~Interpretations~~ Committee observed that the particular transaction in the submission might not be clearly captured within the scope of any IFRS Standard[1]. In the absence of a Standard that specifically applies to a transaction, an entity applies paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy to the transaction. In doing so, paragraph 11 of IAS 8 requires an entity to consider:

a. whether there are requirements in IFRS Standards dealing with similar and related issues; and, if not;

b. how to account for the transaction applying the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*.

The ~~Interpretations~~ Committee noted that, applying paragraph 10 of IAS 8, the accounting policy developed must result in information that is (i) relevant to the economic decision-making needs of users; and (ii) reliable—ie represents faithfully the financial position, financial performance and cash flows of the entity; reflects the economic substance; and is neutral, prudent and complete in all material respects. The ~~Interpretations~~ Committee also observed that, in considering the requirements that deal with similar and related issues, an entity considers all of the requirements dealing with those similar and related issues, including relevant disclosure requirements.

The ~~Interpretations~~ Committee also observed that the requirements in paragraph 112(c) of IAS 1 *Presentation of Financial Statements* may be relevant if an entity develops an accounting policy applying paragraphs 10 and 11 of IAS 8. This would be the case if additional disclosures are needed to provide information relevant to an understanding of the accounting for, and risks associated with, commodity transactions.

The ~~Interpretations~~ Committee concluded that it would be unable to resolve the question asked efficiently within the confines of existing IFRS Standards. The wide range of transactions involving commodities means that any narrow-scope standard-setting activity would be of limited benefit to entities and would have a high risk of unintended consequences. Consequently, the ~~Interpretations~~ Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

[1] The ~~Interpretations~~ Committee observed, however, that particular IFRS Standards would apply to other transactions involving commodities (for example, the purchase of commodities for use in an entity’s production process, or the sale of commodities to customers).

Appendix B—Copies of comment letters

Ernst & Young Global Limited
6 More London Place
London
SE1 2DA

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
ey.com

International Financial Reporting Standards Interpretations Committee
30 Cannon Street
London
EC4M 6XH

12 January 2017

Dear IFRS Interpretations Committee members,

Invitation to comment - Tentative Agenda Decision: Commodity loans (Agenda Paper 10)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above Tentative Agenda Decision (TAD) discussed by the IFRS Interpretations Committee (the IFRS IC) in November 2016.

We understand the rationale for the above TAD not to add this item to the Agenda, given that the particular transaction in the submission might not be clearly captured within the scope of any IFRS Standard, and the inability of the IFRS IC to resolve this issue efficiently within the confines of existing IFRS standards. We are, however, concerned that neither current IFRS standards, nor the TAD, provide sufficient guidance on this issue.

We believe that either the IFRS IC or International Accounting Standards Board (the Board) should deal with this matter by providing guidance in order to avoid the continued diversity in practice, for this and similar transactions.

The TAD refers to the issue from the banks' perspective. However, the same issue arises for counterparties to the banks and other corporate entities involved in similar transactions involving the borrowing and lending of commodities, particularly in the extractives and agricultural industries. It would be helpful to address this issue both from the banks' and other entities' perspectives.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

SAICA
THE SOUTH AFRICAN INSTITUTE
OF CHARTERED ACCOUNTANTS
develop.influence.lead.

18 January 2017

International Financial Reporting Standards Interpretations Committee
30 Cannon Street
London
EC4M 6XH
Email: ifric@ifrs.org.

Dear IFRS Interpretations Committee members

SAICA SUBMISSION ON THE TENTATIVE AGENDA DECISION (TAD): *COMMODITY LOANS* (NOVEMBER 2016)

The South African Institute of Chartered Accountants (SAICA) is pleased to provide comments on this TAD as discussed by the International Financial Reporting Standards Interpretations Committee (IFRS IC). These views result from deliberations of the APC, which comprises members from reporting organisations (including entities listed on the Johannesburg Stock Exchange Limited (JSE)), regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this tentative agenda decision.

Please do not hesitate to contact us should you wish to discuss any of our comments
Yours faithfully,

18/01/2017

Senior Executive – Corporate Reporting:
Zimkita Mabindla

Date

CC – Chairman of the Accounting Practices Committee:
Kevin Davies

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za
Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People. Proudly South African.

SAICA SUBMISSION ON THE TENTATIVE AGENDA DECISION (TAD): *COMMODITY LOANS* (NOVEMBER 2016)

COMMENTS

We understand that this and similar transactions are widely encountered in the extractive and agricultural sectors, especially with highly marketable commodities. The counterparties are often banks within the financial sector. We also understand that there is a wide diversity in practice that relates to the accounting thereof – all of which were described in agenda paper 10. Very often this diversity is noted between the counterparties of a transaction.

We do appreciate that the lack of guidance in IFRS would make it difficult for a narrow scope amendment by the IFRS IC and that this would be best addressed by the International Accounting Standards Board (Board) as a broader project. However, we would consider this an ideal opportunity for the board to consider these types of transactions with the imminent introduction of IFRS 9 – *Financial Instruments* and IFRS 15 – *Revenue from Contracts with Customers*.

We therefore would in the interim encourage the IFRS IC to consider providing additional guidance in the TAD which considers both:

- Considerations that should be given when developing a policy in terms of paragraph 10 of IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* and the relevant disclosures that should be provided in paragraph 112(c) of IAS 1 – *Presentation of Financial Statements*; and
- The TAD should clearly state that this is not solely related to "banks" in the financial sector, but also to the counterparties of the transaction irrespective of the industry sector.

#594865

ASCG • Zimmerstr. 30 • 10969 Berlin

Mr Henry Rees
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 25 January 2017

Dear Henry,

IFRS IC's tentative agenda decisions in its November 2016 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on two of the tentative agenda decisions, taken by the IFRS Interpretations Committee (IFRS IC) and as published in the November 2016 *IFRIC Update*. Please find our detailed comments in the appendix to this letter.

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow
President

Appendix A – Comments on tentative agenda decisions

IAS 28 – Fund manager's assessment of significant influence

We do not fully agree with the IFRS IC's decision and some of the findings. Contrary to the IFRS IC's findings, we consider the question of whether the fund manager acts as a principal or an agent being relevant, even if there is significant influence "only".

If we assume that the fund manager does not control the fund, one would then need to assess whether he has significant influence. Even in this assessment, the fund manager's participation in policy decisions must be considered *implicitly*. Further, we refer to our earlier comments made on the previous tentative agenda decision, taken by the IFRS IC in September 2014, which we have submitted in our comment letter dated 21 November 2014 as follows:

> *"... Whereas it is appropriate to state that this issue is not explicitly addressed by IAS 28, we think that the fund manager's participation in policy decisions, combined with its holding, should implicitly be considered when estimating whether the fund manager has significant influence.*
> *This derives from the definition of significant influence in IAS 28.3, which is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Since – as to the submitted issue – the fund manager is participating in the financial and operating policy decisions of the investee, as a first step, an assessment has to be made whether the fund manager has control (IFRS 10.7) or joint control (IFRS 10.9) of the investee. This assessment by the fund manager shall include all facts and circumstances (IFRS 10.8) including whether it is a principal or an agent (IFRS 10.18). An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (IFRS 10.B58). Therefore, the assessment of control, joint control or, if neither, significant influence by the fund manager shall include the participation in financial and operating policy decisions that it undertakes on behalf of, and for the benefit of, others. As to our knowledge, this understanding is common in practice, with no diversity ...."*

Finally, we do not agree with the conclusion and do not understand the reasoning, that (and why) the IFRS IC "is unable to resolve the question efficiently…". Assuming that the IFRS IC takes the view that IFRS 10 and IAS 28 do not provide basis for a clear answer, we believe that the IFRS IC should take up their responsibility in developing possible ways forward. As outlined in other consultations, we do not find it appropriate to state 'consistent application' as the overarching goal on the one hand and to acknowledge (but not react on) existing diversity on the other.

Commodity Loans

We do not fully agree with the IFRS IC's findings and its tentative decision. We agree with the finding that the particular transaction might not be clearly captured within the scope of any specific IFRS; hence, IAS 8 comes into play. We also agree with the conclusion that, given the wide range of transactions involving commodities, any narrow-scope standard setting activity (ie. an amendment or a clarification) would be of limited benefit.

However, the IFRS IC's finding that applying IAS 8.10 et seq. was a sufficient basis for developing an accounting policy to the transaction appears contradictory in itself, since the IFRS IC themselves was not able to provide an answer to the specific issue in the submission by applying IAS 8.10 et seq. Generally speaking, the IFRS IC should at least be able to give answers on basic aspects (e.g. recognition of both an asset and a liability, gross or net presentation, transfer of risks and rewards). Therefore, we strongly urge the IFRS IC to reconsider the wording of its agenda decision.

Deloitte Touche Tohmatsu Limited
2 New Street Square
London
EC4A 3BZ

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 1198
www.deloitte.com/about

Direct phone: +44 20 7007 0884
Direct fax: +44 20 7007 0158
vepoole@deloitte.co.uk

27 January 2017

Chair
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Sir

Tentative agenda decision – Commodity loans

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for guidance on the accounting for a commodity loan transaction.

We agree with the statement in the tentative agenda decision that the transaction described might not be clearly captured within the scope of any IFRS Standard and that addressing such transactions effectively would require actions beyond the scope of the Committee's activities. However, we do not believe that the discussion of the general requirements of IAS 8 will be helpful to preparers without any guidance on how those principles might be applied to the transaction described. We also note that transactions settled in commodities are becoming more common and more varied and as a result the gap in literature noted in the tentative agenda decision is becoming more problematic.

There are now a range of transactions in which commodities are used, to a greater or lesser extent, 'as currency' rather than in a more traditional sale by a producer to a customer intending to use the commodity in a production process. IFRSs currently provide no guidance on how to characterise or account for such transactions and include limited disclosure requirements when compared to purely financial transactions within the scope of IFRS 7 *Financial Instruments: Disclosures*. As such, we recommend that the broader issue of commodity-settled transactions be referred to the IASB for further consideration as the current lack of guidance has the potential to result in both diversity in practice and action by national or regional bodies to either interpret IFRSs or add further disclosure requirements for commodity transactions.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Organismo Italiano di Contabilità – OIC
(The Italian Standard Setter)
Italy, 00187 Roma, Via Poli 29
Tel. 0039/06/6976681 fax 0039/06/69766830
e-mail: presidenza@fondazioneoic.it

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom
ifric@ifrs.org

6 February 2017

Re: IFRS Interpretations Committee tentative agenda decisions on commodity loans

Dear IFRS Interpretations Committee members,

We are pleased to have the opportunity to provide our comments on the IFRS Interpretations Committee ('IFRS IC') tentative agenda decision on commodity loans issued in November 2016.

OIC agrees with the technical conclusion reached by IFRS IC on this issue. We agree that the particular transaction in the submission might not be clearly captured within the scope of any IFRS Standards and consequently an entity should apply paragraphs 10 and 11 of IAS 8 in developing and applying an accounting policy to the transaction. This, in our view, may lead to divergence in practice.

We acknowledge that IFRS IC would be unable to resolve the question asked efficiently within the confines of existing IFRS Standards. However, we think that the accounting for commodity loans should be brought to the IASB's attention.

Consequently, we suggest modifying the wording of the final agenda decision in order to recommend the Board to consider addressing this issue.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)