STAFF PAPER

24 March 2015

IFRS Interpretations Committee Meeting

Project	**IAS 21 *The Effects of Changes in Foreign Exchange Rates***
Paper topic	Draft Interpretation—Foreign Currency Transactions and Advance Consideration

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Introduction

1. The IFRS Interpretations Committee (the 'Interpretations Committee') received a submission asking how to determine which exchange rate to use when reporting revenue transactions denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In particular, the submission described a circumstance in which the customer paid for the goods or services in advance.

2. The issue was initially discussed by the Interpretations Committee at its meeting in November 2014.[1] At the Interpretations Committee's meeting in January 2015, the Interpretations Committee directed the staff to prepare a draft of a proposed Interpretation of IAS 21 for public comment.[2] It tentatively agreed that the proposed Interpretation should provide guidance on identifying the date of the transaction for foreign currency transactions in circumstances in which a prepayment asset or deferred income liability is recognised before the related asset, expense or income (ie including, but not restricted to, revenue transactions). The IFRIC *Update* for the

[1] See Agenda Paper 14 for the Interpretations Committee's meeting in November 2014.

[2] See Agenda Paper 5 for the Interpretations Committee's meeting in January 2015.

Interpretations Committee meeting in January 2015 summarises all the decisions made at that meeting and is reproduced in Appendix A.

3. Paper 2A contains a draft of the proposed draft Interpretation. While the staff were drafting the proposed Interpretation, some specific questions of clarification arose from some members of the Interpretations Committee; some IASB members when we informally consulted them about the issue; and the staff. These questions are addressed in this paper.

4. This purpose of this paper is:

   (a) to inform the Interpretations Committee of the informal comments from IASB members;

   (b) to clarify the scope of the proposed Interpretation to consider further the interaction of the proposed Interpretation with the following aspects of IFRS 15 *Revenue from Contracts with Customers*:

      (i) unconditional right to consideration in advance of the recognition of revenue;

      (ii) contract assets;

      (iii) variable consideration;

      (iv) significant financing components;

      (v) non-cash consideration.

   (c) to consider the use of the term 'deferred income liability';

   (d) to clarify the proposed transition provisions of the proposed Interpretation; and

   (e) to ask the Interpretations Committee if it has any further substantive comments on the draft Interpretation (subject to any comments arising from the above).

5. If the Interpretations Committee agrees with the proposed draft Interpretation in Paper 2A (after any amendments agreed at the meeting), the next step is to inform the IASB at one of its forthcoming meetings of the Interpretations Committee's intention to publish the draft Interpretation for public comment. Provided that no significant matters arise from the IASB meeting, we will ask the Interpretations Committee at

this meeting if it agrees to the staff preparing a ballot draft of the proposed draft Interpretation for balloting by the Interpretations Committee. This will be conducted by written ballot.

Informal feedback from IASB members

6. We consulted IASB members at various meetings in February 2015 to inform them of the tentative decisions taken by the Interpretations Committee and to obtain their individual views on this issue. We did not ask the IASB members to make any decisions when we consulted them.

7. In summary, the informal comments arising from IASB members were as follows:

   (a) A few IASB members thought that the amount of revenue recognised should not depend upon the timing of the receipt of consideration and thus did not agree with approach in the proposed Interpretation.

   (b) Other IASB members thought that the approach in the proposed Interpretation was a valid interpretation of IAS 21. They noted that it reflects the fact that an entity is no longer exposed to foreign exchange risk in respect of the foreign currency transaction once it has received or paid any advance consideration.

   (c) One IASB member noted that a similar issue in respect of the non-cash consideration requirements in IFRS 15 has been raised at the Transition Resource Group for Revenue Recognition (TRG). The issue is which date should be used to measure the fair value of non-cash consideration for inclusion in revenue. The IASB member observed that it would be preferable if there was consistency with the approach to determine the date of the foreign exchange rate for translating foreign currency consideration for inclusion in revenue, if possible. This is considered further in paragraphs 51-57 of this paper (Issue 7).

   (d) Some IASB members asked how the proposed Interpretation would apply to the significant financing component requirements and the variability of consideration requirements in IFRS 15. Significant financing components are considered in paragraphs 45-50 (Issue 6) of this paper. Variable consideration is discussed further in paragraphs 37-39 (Issue 4), paragraphs 41-44 (Issue 5) and paragraph 55 (Issue 7).

Scope of the proposed Interpretation

8. At the January 2015 meeting, the Interpretations Committee agreed that the proposed Interpretation should apply to foreign currency transactions in circumstances in which foreign currency consideration gives rise to the recognition of a non-monetary prepayment asset or a non-monetary deferred income liability in advance of the recognition of the corresponding asset, expense or income.

9. However, the Interpretations Committee noted that the proposed interpretation would not be applicable when the asset, expense or income is measured at its fair value on initial recognition, such as, for example, business combinations, financial instruments and share-based payments.

10. In this section, we would like to clarify:

    (a) that the proposed Interpretation should apply to non-cash consideration that is denominated or priced in a foreign currency that meet the scope criteria in paragraphs 4-5 of the proposed Interpretation (Issue 1); and

    (b) that for transactions for which the amount of the non-monetary prepayment asset or non-monetary deferred income liability is remeasured on initial recognition of the related (part of the) asset, expense or income to reflect the fair value in a foreign currency of the consideration given up on initial recognition of the related (part of the) asset, expense or income should also be excluded from the scope of the proposed Interpretation (Issue 2).

Issue 1: Non-cash consideration that is denominated or priced in a foreign currency

11. At the January 2015 meeting, the staff recommended that the proposed Interpretation should be applicable only to foreign currency *cash* transactions. However, it was

suggested that the Interpretation should not be restricted to cash transactions. We have therefore reconsidered this point.

12. We note that IAS 21 applies to both cash and non-cash transactions. In particular, the requirements for determining the date of the transaction for the purposes of determining the exchange rate to apply on initial recognition in paragraphs 21 and 22 of IAS 21 do not distinguish between cash and non-cash transactions.

13. In paragraph 67 of Agenda Paper 5 for the January meeting of the Interpretations Committee, we pointed out that non-cash consideration is often recognised at fair value (eg IFRS 15, IFRS 10 *Consolidated Financial Statements,* IFRS 3 *Business Combinations,* IFRS 2 *Share-based Payment*). Consequently, for some non-cash transactions, the proposed Interpretation will not be applicable. However, this will not always be the case, as discussed in paragraphs 15-23 below.

14. We think that if we can appropriately articulate the principle about when the proposed Interpretation is not applicable because the asset, expense or income (or part of it) is measured at fair value on its initial recognition, there is no need to restrict the scope of the Interpretation to cash denominated in a foreign currency. This principle is discussed in paragraphs 15–23.

Issue 2: Transactions measured at fair value on initial recognition

15. The principles in paragraph 23(c) of IAS 21 require that when a non-monetary item is measured at fair value in a foreign currency, it is translated using the exchange rate at the date when the fair value was measured instead of the date of initial recognition.

16. Consequently, if, after the initial recognition of a non-monetary prepayment asset or a non-monetary deferred income, that amount is remeasured to reflect fair value in a foreign currency on initial recognition of the related asset, expense or income (or part of it), the proposed Interpretation would no longer be applicable.

17. We have identified two circumstances in which this occurs:

    (a) the asset, expense or income is measured at its fair value on initial recognition instead of at cost (eg financial instruments, identifiable assets and liabilities in a business combination);

(b) the asset, expense or income is initially recognised at cost or the transaction price, but it is measured initially:

(i) at its fair value as opposed to the fair value of the consideration paid or received (eg when goods or services are received in an equity-settled share-based payment purchases (provided that fair value can be estimated reliably); purchases of property, plant and equipment (PPE) exchanged for non-monetary asset(s) if the fair value of the PPE received is more clearly evident than the fair value of the asset given up); or

(ii) using the fair value of the consideration (eg non-cash consideration included in revenue in accordance with IFRS 15 (provided it can be reliably measured); determining the amount of consideration in the calculation of goodwill in accordance with IFRS 3; and purchases of PPE (unless the fair value of the asset received is more clearly evident)).

18. At the January 2015 meeting of the Interpretations Committee we agreed that the proposed Interpretation should not apply in the first case identified in paragraph 17(a) above, ie when the asset, expense or income is measured at its fair value on initial recognition instead of cost. For example, IFRS 9 *Financial Instruments* requires the fair value to be measured at the date of initial recognition of the financial asset or financial liability and paragraph 18 of IFRS 3 requires that identifiable assets and liabilities are recognised using the fair value at acquisition date.

19. In the second scenario, outlined in paragraph 17(b), the consideration that is recognised at its fair value for inclusion in the initial cost of the asset, expense or income is often non-cash consideration. The Standards are generally not as clear about the date that should be used to measure the fair value of the asset, expense or income or the consideration in such circumstances. There are two possibilities:

(a) the consideration (or asset, income or expense) is recognised at fair value at the date that the prepayment asset or deferred income liability is recognised. This becomes (part of) the cost or transaction price and the amount of the consideration is not subsequently remeasured to fair value on initial recognition of the related asset, expense or income; or

(b) on initial recognition of the asset, expense or income, the consideration (or the asset, expense or income) is measured at fair value for inclusion in the cost or the transaction price at a measurement date other than the date of initial recognition of the related prepayment asset or deferred income liability.

20. In the first scenario in paragraph 19(a), we think that the proposed Interpretation should apply, because after the prepayment asset and the deferred income liability is initially recognised, that amount is included unchanged in the initial measurement of the related asset, expense or income.

21. However in the second scenario in paragraph 19(b), the proposed Interpretation would not apply, because the date of measurement of the fair value of the item would determine the date of the exchange rate to use to translate the asset, expense or income. For example, goodwill is initially measured, in accordance with IFRS 3, by reference to the acquisition-date fair value of consideration.

22. Consider an example of a purchase of a machine. The consideration is CU100 cash plus an item of (dissimilar) PPE that is priced in a foreign currency in accordance with IFRS 13.[3] This existing PPE has a carrying amount of CU25, but a fair value of FC50. On 1 June 20X0, when the spot exchange rate is CU1:FC1.1, the entity pays the supplier the CU100 cash and delivers the PPE given up. On 1 July 20X0, the entity receives delivery of the machine and recognises it as a new item of PPE.

23. Paragraph 6 of IAS 16 defines cost as 'the amount of cash and cash equivalents paid or the *fair value of the other consideration given* to acquire an asset at the time of its acquisition or construction…'. Consistently with the entity's usual practice, it derecognises the CU100 cash and its PPE with a carrying amount of CU25 on 1 June 20X0, recognising a prepayment asset of CU155 (ie, the CU100 cash plus the fair value of the PPE given up at an exchange rate of CU1:FC1.1 (CU50 × 1.1=CU55)). The entity recognises a gain of CU30 (CU55-CU25) on the disposal of its PPE given up. The entity recognises its machine on 1 July 20X0 at its cost of CU155, which is same as the carrying amount of the prepayment asset immediately before

[3] In this paper, functional currency units as are expressed as 'CU' and foreign currency units are expressed as 'FC'.

derecognition. In this case, the date of transaction in respect of the non-cash consideration that is priced in a foreign currency is 1 June 20X0 and the entity would not retranslate the non-cash consideration for inclusion in the cost of the PPE at 1 July 20X0. Hence the proposed Interpretation would be applicable.

Summary

24. In summary, to capture the circumstances outlined in paragraphs 17(a) and 19(b), we think that the proposed Interpretation should apply to transactions for which:

> after the initial recognition of a non-monetary prepayment asset or non-monetary deferred income, that foreign currency amount is not remeasured on initial recognition of the related (part of the) asset, expense or income to reflect the fair value in a foreign currency of either the consideration or the related asset, expense or income.

25. We also recommend that the proposed Interpretation should apply to cash and non-cash consideration that is denominated or priced in a foreign currency.

26. These recommendations are reflected in paragraph 4(a) and (c) of the proposed draft Interpretation in Agenda Paper 2A.

Questions 1–2 for the Interpretations Committee

1. Does the Interpretations Committee agree that the proposed Interpretation should apply to the transactions in the circumstances described in paragraph 24?
2. Does the Interpretations Committee agree that the proposed Interpretation should apply to cash and non-cash consideration that is denominated or priced in a foreign currency?

Interaction with IFRS 15

27. Our proposed Interpretation is an interpretation of IAS 21, not IFRS 15. That is, an entity applies other Standards (including IFRS 15) to the transaction to determine the basis for the recognition and measurement of a foreign currency transaction and then

applies IAS 21 (and the proposed Interpretation of IAS 21 if relevant) to those foreign currency amounts. However, the issue we are addressing arose in respect of revenue transactions in a foreign currency, and because IFRS 15 is a new Standard, questions are naturally arising about how the proposed Interpretation interacts with various aspects of IFRS 15. We have analysed these questions in this paper to ensure that there is no fatal flaw with the proposed Interpretation or illustrative examples that accompany the Interpretation.

28. In accordance with IFRS 15, the transaction (or each part of it) is first recognised in the financial statements for the purposes of applying IAS 21 on the earlier of the following four events:

(a) when payment is due in respect of an unconditional right to consideration, at which date the entity recognises a receivable and a corresponding contract liability[4];

(b) on receipt of the consideration, at which date the entity recognises the consideration as an asset and a corresponding contract liability;

(c) on the transfer of the goods or services (ie on performance) provided that there is no constraint on variable consideration, at which date the entity recognises the revenue and a corresponding contract asset (if the right to consideration is not unconditional) or a receivable (if the right to consideration is unconditional)[5]; or

(d) the date at which the entity reassesses its estimate of variable consideration and determines that it can recognise additional amounts of revenue subsequent to the date of the transfer of goods and services (eg because the constraint on variable consideration no longer applies). In such circumstances the entity recognises the additional revenue in respect of past performance and a corresponding contract asset or receivable.

[4] Appendix A of IFRS 15 defines a contract liability as 'an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer)'.

[5] Appendix A of IFRS 15 defines a contract asset as 'an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)'.

29. The interaction of the proposed Interpretation with the following aspects of IFRS 15 *Revenue from Contracts with Customers* are discussed in this section:

    (a) unconditional right to consideration in advance of the recognition of revenue (Issue 3);

    (b) contract assets (Issue 4);

    (c) variable consideration and Example 2 (Issue 5);

    (d) significant financing components (Issue 6); and

    (e) non-cash consideration (Issue 7).

Issue 3: Unconditional right to consideration in advance of the recognition of revenue

30. In accordance with paragraph 106 of IFRS 15, if a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (ie a receivable) before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability (ie a deferred income liability) when the payment is made or the payment is due (whichever is earlier).[6] [7]

31. Hence, in circumstances in which payment has not been received when due, in accordance with IFRS 15 an entity would recognise a contract liability before it receives the consideration or transfers the goods or services to the customer.

32. On applying the proposed Interpretation, the exchange rate used to translate the related revenue would be the spot exchange rate on the date that the contract liability was recognised (ie the date the payment for the unconditional right to consideration was due or the date the payment was received (if earlier

33. To accommodate the recognition of a contract liability before the receipt of the consideration as anticipated in IFRS 15, we have been careful in the drafting of the proposed Interpretation (in particular in paragraph 7 of the Consensus) to refer to date

[6] It should be noted that, in such circumstances, a receivable only arises if the contract is non-cancellable before the entity performs.

[7] We note that paragraph BC325 of IFRS 15 notes that 'the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration'.

of initial recognition of the deferred income liability instead of receipt of the advance consideration. Similarly, in respect of purchases, we refer to the date of initial recognition of the prepayment asset instead of the date of payment of advance consideration.

Question 3 for the Interpretations Committee
3. Does the Interpretations Committee agree that the proposed Interpretation should refer to the date of initial recognition of the deferred income liability or prepayment asset instead of to the date of payment or receipt of the advance consideration?

Issue 4: Contract assets

34. In accordance with paragraphs 107 and 108 of IFRS 15, if an entity recognises revenue but does not yet have the unconditional right to consideration, it recognises a contract asset, which is within the scope of IFRS 15. At the point at which the entity has an unconditional right to consideration it recognises a receivable, which is accounted for in accordance with IFRS 9 (or another relevant Standard if it is non-financial consideration).

35. In Example 2 and Example 4 of the proposed draft Interpretation, the fact patterns state that on delivery of the goods or services the right to consideration is unconditional. Thus, a receivable within the scope of IFRS 9 (and not a contract asset) is recognised on recognition of revenue for consideration not yet received. As noted in Example 4, this receivable is retranslated because it is a monetary item and the resulting exchange rate movements are recognised in profit or loss (but not as part of revenue).

36. The Examples do not illustrate the accounting treatment of contract assets. A question has been asked about what the accounting would be for the foreign exchange element if a contract asset instead of a receivable was recognised on the recognition of revenue for which foreign currency cash consideration is still outstanding. An example of a contract asset arising is given in Example 39 in paragraphs IE201-IE204 of IFRS 15. In this example an entity is contracted to deliver two distinct goods and payment for delivering the first good is conditional upon delivery of the second good.

In that example, the entity recognises the revenue associated with the first delivery on delivery of the first good and also recognises a corresponding contract asset.

37. When there are conditions associated with the right to consideration, the application of IFRS 15 can become more complex. This is because it is necessary to ascertain whether the terms of the contract give rise to some variable consideration and if so whether the constraint for variable consideration in paragraphs 56-58 of IFRS 15 applies. The constraint is that variable consideration can only be recognised on the transfer of the goods or services if it is highly probable that a significant reversal in revenue will not occur when the uncertainty is resolved.

38. To the extent that it is highly probable that there will not be a significant reversal of revenue, revenue is recognised as the entity transfers the goods or services and a corresponding contract asset is recognised using the exchange rate at the date the revenue is recognised, in accordance with paragraphs 21 and 22 of IAS 21. This contract asset represents a (conditional) right to consideration, which, if the consideration is to be received in foreign currency cash, meets the definition of a monetary item in paragraph 8 of IAS 21[8]. In such circumstances the contract asset is required to be retranslated using the spot exchange rate at each subsequent reporting date and on derecognition, with the exchange gains and losses being recognised in profit or loss (paragraphs 23 and 28 of IAS 21).

39. To the extent that it is *not* highly probable that there will not be a significant reversal of revenue, that constrained variable revenue will not be recognised until it is highly probable that there will not be a significant reversal of revenue, sometime after the transfer of the goods or services. In accordance with paragraph 59 of IFRS 15, the entity must reassess the estimated amount of variable consideration and whether the constraint for variable consideration applies at each subsequent reporting date. The entity then adjusts revenue accordingly. If an additional amount of revenue in a foreign currency in respect of past performance is recognised as a result of that reassessment, the entity would recognise at that date that additional revenue and either a contract asset or a receivable. The date of transaction for that additional revenue is

[8] Paragraph 8 of IAS 21 defines monetary items as 'units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency'.

the date that it is first recognised when the constraint for variable revenue no longer applies. If there is a reversal of previously estimated and recognised revenue, the revenue previously recognised will be reversed in the period of the re-estimation.

40. Contract assets arise when consideration has yet to be received *after* the transfer of the related goods or services. However the issue being addressed in the proposed Interpretation is which exchange rate should be used when foreign currency consideration is received *before* the recognition of revenue. Consequently, the staff do not intend to add examples to the proposed Interpretation to illustrate the accounting treatment for contract assets.

Question 4 for the Interpretations Committee
4. Does the Interpretations Committee agree not to include guidance on the accounting for contract assets in the proposed Interpretation of IAS 21 or in the examples accompanying the proposed Interpretation?

Issue 5: Variable consideration and proposed Example 2

41. In Appendix C to Agenda Paper 5 for the January 2015 Interpretations Committee meeting we provided an analysis of the interaction of the proposed Interpretation with the variable consideration and non-cash consideration requirements of IFRS 15. This is reproduced in Appendix B of this paper. We concluded that the variable consideration requirements in IFRS 15 do not apply to variability in value that is only due to movements in foreign exchange rates. Consequently, if the amount of foreign currency receivable is fixed, changes in value due to movements in exchange rates after the recognition of revenue are not included in revenue as adjustments to variable consideration.

42. Example 2 of the proposed draft Interpretation is an illustration of a revenue transaction recognised at a single point in time, but for which payment is made partly in advance of the delivery of the goods and partly in arrears. In the fact pattern, the transaction price is a fixed amount of foreign currency, the amount receivable in advance is non-refundable and on delivery of the goods the entity has an unconditional right to the remaining consideration. The fact pattern also assumes that

on applying IFRS 15 the entity determines that the revenue should be recognised at the date of delivery of the goods.

43. The Example concludes that the revenue is recognised using the spot exchange rate at the date of receipt of the advance consideration (ie when the contract liability is recognised) for the consideration received in advance and the spot exchange rate at the date of delivery of the goods in respect of the remaining consideration received in arrears. Because the Example does not suggest subsequently adjusting revenue to reflect changes in exchange rates after the date of delivery of the goods in respect of the consideration received in arrears, it is implicitly not treating the variability in foreign exchange as variable consideration on applying IFRS 15. It has been suggested that the Example might more explicitly state that variation in value of consideration due to foreign exchange movements on its own is not treated as variable consideration on applying IFRS 15.

44. Care needs to be taken to ensure that we are not analysing or interpreting IFRS 15 in an interpretation of IAS 21. However on balance, the staff are proposing to insert the following sentence into the fact pattern for Example 2 (and similarly for Example 4):

> 'Entity B determines that because the amount of consideration in the foreign currency is fixed, the variable consideration requirements in IFRS 15 do not apply. Hence it concludes that revenue is recognised at the date of delivery of the goods and the amount of the transaction price is not subsequently re-estimated.'

Question 5 for the Interpretations Committee
5. Does the Interpretations Committee agree to include in Example 2 and Example 4 a reference to the fact that the entity determines that, because the amount of consideration in the foreign currency is fixed, the variable consideration requirements in IFRS 15 do not apply?

Issue 6: Significant financing components

45. Paragraphs 60-65 of IFRS 15 require that if there is a significant financing component, the entity should adjust the consideration to reflect the time value of

money in determining the transaction price. However, as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

46. Paragraph 64 of IFRS 15 states that an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer.

47. A question has been asked about how the proposed Interpretation would apply to situations in which there was a significant financing component due to consideration being received in advance of the transfer of goods or services.

48. If the amount of the accretion of the effects of the time value of money in respect of a non-monetary contract liability was determined in a foreign currency, the date of the transaction for the accreted amounts would be the date(s) that they are recognised as part of the contract liability.

49. For example, suppose an entity entered into a contract with a customer to sell goods for FC100 at the date of delivery in 14 months' time or FC90 receivable now. The entity receives FC90 from the customer now and recognises a contract liability for FC90 translated using the exchange rate at that date. The entity determined that the difference of FC10 (between FC90 now and FC100 in 14 months' time) was a significant financing component. It therefore recognised the FC10 as interest expense in profit or loss and as a corresponding increase in the contract liability over the 14 months from the date of receipt of the consideration to the date of delivery of the goods. The FC10 would be translated using the exchange rates over the period from contract inception to the delivery of the goods. (In accordance with paragraph 22 of IAS 21, average exchange rates may be used if exchange rates do not fluctuate

significantly.) Hence, applying the approach in the proposed Interpretation, on transfer of the goods, revenue is recognised for FC100, of which:

(a) FC90 is translated using the exchange rate at the date of recognition of the initial FC90 contract liability; and

(b) FC10 is translated using the exchange rates over the period of the significant financing.

50. We do not propose to address this explicitly in the proposed Interpretation, because we think that this is the expected consequence of applying IAS 21 and the proposed Interpretation.

Question 6 for the Interpretations Committee
6. Does the Interpretations Committee agree not to address significant financing components in the proposed Interpretation of IAS 21 or in the examples accompanying the proposed Interpretation?

Issue 7: Non-cash consideration

51. Cash denominated in a foreign currency is not 'non-cash consideration'. Accordingly, the requirements of IFRS 15 for non-cash consideration do not apply. However, foreign currency cash has some features that are similar to non-cash consideration, in that its fair value may vary (from the perspective of an entity's functional currency) because of the form of the consideration—in this case due to movements in foreign exchange rates. A similar issue has arisen in respect of which date should be used to measure the fair value of non-cash consideration for inclusion in revenue in accordance with paragraphs 66-69 of IFRS 15. This issue was discussed at the TRG's meeting in January 2015. The IASB and FASB are also discussing these issues at a joint Board meeting on 18 March 2015 (see Agenda Paper 7C and FASB Memo No. 1). The staff will give an oral update on the decisions made by the FASB and the IASB at the meeting of the Interpretations Committee.

52. The TRG considered three alternative views:

(a) View A: the fair value of non-cash consideration is measured at contract inception.

(b) View B: the fair value of non-cash consideration is measured when the non-cash consideration is received or receivable (ie the entity has an unconditional right to consideration).

(c) View C: the fair value of non-cash consideration is measured at the earlier of:

(i) the date that the non-cash consideration is received or receivable; and

(ii) the date that the related performance obligation is satisfied (or as the performance obligation is satisfied, if satisfied over time).

53. The concern raised was that it would be preferable if there was consistency between the approach to determine the date of the foreign exchange rate for translating foreign currency consideration and the approach to determine the date of measurement of the fair value of non-cash consideration for inclusion in revenue.

54. However, we note that the requirements in IAS 21 are not entirely consistent with the principles in IFRS 15 or any of the alternatives considered above, regardless of the approach taken in the proposed Interpretation. This is because in accordance with IAS 21, the exchange rate used to translate a foreign currency transaction on initial recognition is the date that the transaction is *first recognised* in the financial statements. None of Views A, B or C would align with the date of first recognition of the transaction (as summarised in paragraph 28) in all circumstances.

55. For revenue transactions with payments in arrears, the date of the spot exchange rate used to translate consideration in a foreign currency for inclusion in revenue is closest to View C, because if the constraint on variable consideration does not apply, revenue is recognised as the entity satisfies its performance obligations. However if the constraint on variable consideration does apply, the entity may recognise additional revenue after the date of transfer of the goods or services on subsequent reassessment of the variable consideration. This later date would be the date of first recognition of that additional revenue (or all of it, if all of the revenue is constrained), which in accordance with IAS 21 would be the date of the exchange rate used to translate that amount of the revenue. However, in similar circumstances for previously constrained variable non-cash consideration, applying View C would mean that the measurement

date of the fair value of the additional non-cash consideration would be at the (earlier) date of the transfer of the goods or services.

56. In circumstances in which a non-monetary contract liability is recognised before the recognition of the related revenue, the Interpretations Committee's tentative conclusions as proposed in the draft Interpretation are consistent with both View B and View C, but not with View A.

57. Finally, we note that if non-monetary non-cash consideration is priced in a foreign currency, the non-cash consideration would be translated using the exchange rate at the date the fair value was measured in accordance with paragraph 23(c) of IAS 21. As noted in paragraphs 15-23, the proposed Interpretation would not apply if this date was not the date that the contract liability is initially recognised. Thus we think that the proposed Interpretation would in any event not conflict with the application of the non-cash consideration requirements in IFRS 15 for non-cash consideration that is priced in a foreign currency.

Question 7 for the Interpretations Committee

7. Does the Interpretations Committee agree with the analysis of the consistency of IAS 21 and the proposed Interpretation with the treatment of the fair value of the measurement of non-cash consideration given in paragraphs 51-57 above?

Issue 8: Use of the term 'deferred income liability'

58. In our agenda papers and the proposed draft Interpretation, we have used the term 'deferred income liability' to refer to an entity's obligation to transfer goods or services that is recognised in the financial statements because, for example, the consideration has been received (or falls due) before the recognition of the revenue or income due to the transfer of goods or services.

59. The term 'deferred income' is understood within the accounting profession, but is not generally used within IFRS. Indeed, IFRS 15 refers to 'contract liability' instead of

'deferred income liability'.[9] The reason for this is because before the entity has performed under the contract, there is no right to, or recognition of, income. Thus it cannot be 'deferred income'.

60. Contract liability is defined in IFRS 15 within the context of a revenue transaction. Hence, it would not be a suitable term to use in the proposed Interpretation, because the proposed Interpretation applies to a broader range of transactions.

61. We could continue to use the term 'deferred income liability' in the proposed Interpretation. However we think that it would be preferable to use an alternative term, such as 'performance liability' instead, which better reflects that an entity has an obligation to transfer goods or services (see paragraph 2 of the proposed draft Interpretation in Agenda Paper 2A).

Question 8 for the Interpretations Committee
8. Does the Interpretations Committee agree to replace the term 'deferred income liability' with 'performance liability' (or similar) in the proposed draft Interpretation?

Issue 9: Transition

62. At the meeting in January 2015, the Interpretations Committee tentatively agreed that on initial application of the proposed Interpretation, entities should have the option of relief from retrospectively restating all assets, expenses and income that were completed transactions before either the start of the current reporting period or the start of a prior reporting period that is presented in the first reporting period of application.

63. The question is: what do we mean by 'completed transactions' before the start of a reporting period?

64. We used the phrase 'completed transactions' to be consistent with the transition requirements in IFRS 15. Paragraph C2(b) of IFRS 15 states that 'a completed

[9] Contract liability is defined in Appendix A of IFRS 15 as 'an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer'.

contract is a contract for which an entity has transferred all of the goods or services identified in accordance with revenue guidance that is in effect before the date of initial application'.

65. Our proposed Interpretation affects transactions other than revenue transactions, including the purchase of assets. We also note that, unlike IFRS 15, the proposed Interpretation does not affect the timing of recognition of transactions (because this is determined by other Standards), merely which exchange rate should be used to measure those transactions.

66. Therefore we are, in essence, proposing that the draft Interpretation may be applied prospectively from the start of the current reporting period or the start of a prior reporting period presented in the financial statements of the current reporting period. That is, on first application, the draft Interpretation need only apply to assets, expenses and income recognised after the start of the current reporting period (or a prior reporting period presented with the current reporting period).

67. We think that it would be clearer to say this in the proposed draft Interpretation. Consequently we recommend that the transition requirements should refer to prospective application from a specific date instead of referring to 'completed transactions' (see paragraph A2(b) of the proposed draft Interpretation in Agenda Paper 2A).

Question 9 for the Interpretations Committee

9. Do you agree that on initial application an entity may apply the proposed Interpretation prospectively from:

   (a) the start of the reporting period in which an entity first applies the [draft] Interpretation; or

   (b) the start of a prior reporting period for which comparative information is presented in the financial statements of the reporting period in which an entity first applies the [draft] Interpretation?

Next steps

68. Following this meeting of the Interpretations Committee, the staff will amend the proposed draft Interpretation in Agenda Paper 2A as agreed by the Interpretations Committee. We will also update the Basis for Conclusions to the proposed draft Interpretation to reflect the tentative decisions made at the meeting.

69. If you are satisfied that you have addressed all of the matters necessary in developing the proposals, we will ask you to vote at this meeting to determine whether there is general agreement that the staff should prepare the draft Interpretation for balloting (subject to no significant matters arising from the IASB discussions). General agreement is reached when no more than four members have voted against the proposal.

70. In accordance with paragraph 7.7 of the *IASB and IFRS Interpretations Committee Due Process Handbook*, the staff will present a paper to the IASB at one of its future meetings. This paper will summarise the steps that have been taken in developing the proposals and will recommend a comment period for the draft Interpretation. The comment period is usually a minimum period of 90 days.

71. If the Interpretations Committee reaches such general agreement and there are no significant matters arising from the IASB meeting, we will conduct a written ballot of the draft Interpretation.

72. IASB members also receive ballot drafts of the draft Interpretation. If four or more IASB members object to the release of the draft Interpretation during the balloting process, the draft Interpretation is not released. The IASB then determines the next steps (if at all) for the issue (see paragraph 7.10 of the Due Process Handbook).

Questions 10–12 for the Interpretations Committee

10. Does the Interpretations Committee have any further substantive comments on the draft Interpretation (subject to any comments arising from the above)?

11. Are you satisfied that you have addressed all relevant matters in developing the proposals?

12. Provided that the IASB does not raise any significant matters, do you agree that the staff should prepare a ballot draft of the proposed draft Interpretation for public comment?

APPENDIX A

IFRIC Update for January 2015

IAS 21 *The Effects of Changes in Foreign Exchange Rates*—Revenue transaction denominated in a foreign currency: What is the date of the transaction for the purpose of identifying the applicable exchange rate for revenue recognition? (Agenda Paper 5)

The Interpretations Committee continued its consideration of a submission that asked how to determine which exchange rate to use when reporting revenue transactions denominated in a foreign currency in accordance with IAS 21 The *Effects of Changes in Foreign Exchange Rates*. In particular, the submission described a circumstance in which the customer paid for the goods or services by making a non-refundable payment in advance.

The Interpretations Committee noted that paragraphs 21–22 of IAS 21 require that a foreign currency transaction should be recorded, on initial recognition in the functional currency, by applying the spot exchange rate at the date on which the transaction first qualifies for recognition in accordance with IFRS.

At its meeting in November 2014, the Interpretations Committee tentatively decided to develop guidance on identifying the date of the transaction for revenue transactions denominated in a foreign currency, as an interpretation of paragraph 22 of IAS 21. The Interpretations Committee tentatively decided that in the circumstances described in the submission, the principle to apply should be that revenue should be recognised using the exchange rate at the date the advance payment is made or the advance payment is due (whichever is earlier).

At its January 2015 meeting, the Interpretations Committee considered the scope of the proposed interpretation, how the principle would apply to more complex scenarios and the effective date and transition requirements of the proposed interpretation.

Scope of the proposed interpretation

The Interpretations Committee tentatively agreed that, as an interpretation of IAS 21, the proposed guidance should not be restricted to revenue transactions, but should also apply to other foreign currency transactions that are similarly affected by the issue. That is, the proposed interpretation should apply to foreign currency transactions in circumstances in which foreign currency consideration is paid or received in advance of the recognition of the corresponding asset, expense or income; ie there is some element of prepayment or deferred income.

However, the Interpretations Committee noted that the proposed interpretation would not be applicable when the asset, expense or income is measured at fair value on initial recognition, such as, for example, business combinations, financial instruments and share-based payments. In addition, the proposed interpretation need not apply to insurance contracts and income taxes.

Applying the principle to more complex scenarios

The Interpretations Committee considered some more complex payment arrangements, including circumstances in which there are multiple payments for multiple goods or services over time. The Interpretations Committee tentatively agreed that:

a. the proposed interpretation should clarify that the date of the transaction for the purpose of paragraphs 21-22 of IAS 21 is determined as the date on which the transaction is initially recognised. If the transaction is initially recognised in stages, the date of the transaction also occurs in stages.
b. this date of the transaction is used to determine the exchange rate used to translate the prepayment asset or deferred income liability, together with the corresponding (portion of) the asset (on initial recognition), expense or income. The prepayment asset or deferred income liability that is recognised in relation to the advance consideration is subsequently derecognised on recognition of the corresponding asset, expense or income. The pattern of derecognition and recognition is determined by applicable IFRS, and is not affected by the denomination of the transaction in a foreign currency.

The Interpretations Committee also tentatively agreed that the proposed interpretation should only deal with circumstances in which the advance consideration is denominated or priced in a foreign currency and gives rise to a non-monetary prepayment asset or deferred income liability.

Effective date and transition

The Interpretations Committee tentatively agreed that:

a. the effective date of any guidance should not be earlier than the effective date of IFRS 15 *Revenue from Contracts with Customers* (ie for accounting periods beginning on or after 1 January 2017), but earlier application should be permitted
b. on initial application entities may apply the proposed interpretation either:
   i. retrospectively in accordance with IAS 8; or
   ii. retrospectively with the cumulative effect of initially applying the interpretation recognised in opening retained earnings at the start of the reporting period in which an entity first applies the proposed Interpretation, or at the start of a prior reporting period presented, but only to transactions that are not completed transactions at that date.
c. no specific provisions or exemptions should be given for first-time adopters.

Next steps

The Interpretations Committee tentatively agreed to publish a draft interpretation for public consultation based on the tentative decisions discussed above. Accordingly, the Interpretations Committee directed the staff to draft a proposed interpretation to be discussed at a future meeting.

APPENDIX B

Interaction with variable consideration and non-cash consideration requirements in IFRS 15[10]

B1. In this appendix, we review the variable consideration and non-cash consideration requirements in IFRS 15, to consider whether the requirements might provide some guidance for the interpretation of paragraph 22 of IAS 21 within the context of foreign currency translation.

B2. The variable consideration requirements in paragraphs 50 and 51 of IFRS 15 state that:

> If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.
>
> An amount of consideration can vary because of *discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items*. The promised consideration can also vary if an entity's entitlement to the consideration is *contingent on the occurrence or non-occurrence of a future event*. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone. [emphasis added]

B3. The transaction price of a revenue contract in which the consideration is due in foreign currency will vary in value in the entity's functional currency. For example if the amount of foreign currency consideration is fixed at FC100, in terms of the entity's functional currency the consideration will vary in value with movements in the exchange rate.

[10] This Appendix reproduces Appendix B of Agenda Paper 5 of the Interpretations Committee meeting in January 2015 for ease of reference.

B4. However, variability in the value of the transaction price in a foreign currency due to exchange rates is not 'similar' to the types of variability listed in italics in the quote in paragraph B2 B2. This is because a variation in value due to exchange rate movements does not alter the amount of the foreign currency consideration to which the entity is entitled under the contract.

B5. Cash denominated in a foreign currency is not 'non-cash consideration'. Accordingly, the requirements in IFRS 15 for non-cash consideration do not apply. However, foreign currency cash has some features that are similar to non-cash consideration, in that its value varies with movements in the market price of the underlying form of consideration (ie foreign exchange rates). Similarly, if the consideration is in the form of shares, then the value of the consideration varies with its market price.

B6. Paragraphs 66 and 68 of IFRS 15 state the following:

> To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.
>
> The fair value of the non-cash consideration may vary because of the form of the consideration (for example, a change in the price of a share to which an entity is entitled to receive from a customer). If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), an entity shall apply the requirements in paragraphs 56–58.

B7. The last sentence in paragraph 68 of IFRS 15 further emphasises that the variable consideration requirements in IFRS 15 do not apply to variability that is only due to the form of consideration—such as variability due to share price movements in respect of shares or foreign exchange movements in respect of foreign currency cash consideration.

B8. Hence we do not think that the variable consideration requirements in IFRS 15 are applicable to the variability that is only due to movements in foreign exchange movements in respect of foreign cash consideration.

B9. IFRS 15 does not state at which date non-cash consideration should be measured at fair value[11]. Consequently, we think that these requirements in IFRS 15 do not provide any further guidance regarding what the appropriate date of transaction might be for the recognition of revenue with foreign currency consideration.

Conclusion

B10. To summarise, we think that the variable consideration requirements in IFRS 15 do not apply to variability in value that is only due to movements in foreign exchange rates. In addition, the non-cash consideration requirements do not apply to cash denominated in a foreign currency. We note that even if applied by analogy, those requirements would not appear to apply to a change in the value of consideration that is solely due to the form of the consideration. Furthermore, we think that these requirements in IFRS 15 do not help to clarify what the date of transaction might be when an entity receives cash in a foreign currency under a contract with a customer.

[11] This issue has already been submitted to the Transition Resource Group for Revenue (TRG) within the context of non-cash consideration and is scheduled for initial discussion at the meeting of the TRG on 26 January 2015. (See TRG submissions log submission number 20.)