STAFF PAPER

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IFRS Interpretation Committee Meeting

Project	**Foreign Currency Transactions and Advance Consideration**
Paper topic	Comment letter summary

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Introduction

1. In October 2015, the IFRS Interpretations Committee ('the Interpretations Committee') published a Draft Interpretation *Foreign Currency Transactions and Advance Consideration* ('draft Interpretation'). This paper provides a summary of the feedback received in response to the draft Interpretation.

2. Paragraphs 21-22 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* require an entity to record a foreign currency transaction on initial recognition in the entity's functional currency, by applying the spot exchange rate to the foreign currency amount at the date of the transaction. The Interpretations Committee received a question about how to determine the date of the transaction applying paragraphs 21-22 of IAS 21. The question is what exchange rate to use to translate the asset, expense or income on initial recognition, in the circumstance in which an entity pays or receives some or all of the foreign currency consideration in advance of the recognition of the related asset, expense or income. The draft Interpretation addressed this question.

Purpose of this paper

3. This paper summarises the points raised in comment letters. The purpose of this paper is to provide information only. Agenda paper 7B analyses the comments received and asks the Interpretations Committee to make decisions about the proposed requirements in the draft Interpretation.

4. This paper is structured as follows:

   (a) Overview of the draft Interpretation (paragraphs 6-12); and

   (b) Comment letter summary to the draft Interpretation

      (i) Overview of responses (paragraphs 13-15);

      (ii) Scope of the draft Interpretation (paragraphs 16-23);

      (iii) Consensus of the draft Interpretation (paragraphs 24-30); and

      (iv) Transition (paragraphs 31-37).

      (v) Editorial (paragraph 38)

Overview of the draft Interpretation

Scope

6. The Interpretations Committee proposed that the draft Interpretation would be applied to foreign currency transactions in which:

   (a) consideration is denominated or priced in a foreign currency;

   (b) the entity recognises a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income (or part of it); and

   (c) the prepayment asset or deferred income liability is non-monetary.

7. The scope of the draft Interpretation excludes transactions measured at fair value on initial recognition and monetary items.

8. The draft Interpretation is not required to be applied to insurance contracts and income taxes.

Consensus

9. For the purpose of determining the spot exchange rate used to translate the related asset, expense or income (or part of it) on initial recognition applying paragraphs 21-22 of IAS 21, the draft Interpretation proposed that the date of the transaction is the earlier of:

    (a) the date of initial recognition of the non-monetary prepayment asset or deferred income liability; and

    (b) the date that the asset, expense or income (or part of it) is recognised in the financial statements.

10. A simple example of a transaction within the scope of the draft Interpretation is the following scenario:

    (a) an entity enters into a sales contract with a customer for delivery of goods or services at T0, payment for which is denominated in a foreign currency;

    (b) the customer pays a non-refundable advance payment at T1; and

    (c) the entity transfers the goods or services to the customer at T2.

11. In accordance with the draft Interpretation, an entity would recognise revenue using the exchange rate at the date on which the customer paid the advance at T1—ie the date of initial recognition of the non-monetary deferred income (contract) liability. This approach reflects that the receipt of the customer advance payment eliminates the entity's exposure to foreign exchange on that part of the consideration.

Transition

12. The draft Interpretation proposed the following transition requirements:

> On initial application, an entity shall apply this [draft] Interpretation either:
>
> (a) retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) prospectively to all assets, expenses and income in the scope of the [draft] Interpretation initially recognised on or after:

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

 (ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the [draft] Interpretation.

Comment letter summary on the draft Interpretation

Overview of responses

13. The comment period for the draft Interpretation ended on 19 January 2016. 45 comment letters have been received. A list of respondents is included in Appendix A to this paper, and a statistical summary by type of respondent and geographical region is included in Appendix B. All of the comment letters are available on the project webpage.[1]

14. Overall, there is support for the proposals set out in the draft Interpretation, indicating that the draft Interpretation clarifies the accounting for foreign currency transactions in which consideration is received or paid in advance of the recognition of the related asset, expense or income.

15. Nonetheless, about half of the respondents identify areas of the draft Interpretation that they think could be developed further. The more significant areas identified are discussed in the following sections.

[1] http://www.ifrs.org/Current-Projects/IASB-Projects/date-of-transaction-identifying-applicable-exchange-rate-revenue-recognition/Draft-Interpretation-October-2015/Pages/Comment-letters.aspx

Scope of the draft Interpretation

General feedback on scope

16. Except for one individual respondent, all respondents support the proposed scope of the draft Interpretation. The dissenting respondent considers that the draft Interpretation should be more principle-based, encompassing both monetary and non-monetary items and that it should adopt more generic terms instead of 'prepayment asset' and 'deferred income liability'.[2] Other comments on terminology are summarised in paragraph 38 of this paper.

17. Those supporting the scope of the draft Interpretation observed the following:

    (a) The issue addressed in the draft Interpretation (ie how to determine the date of the transaction in determining which exchange rate to use on initial recognition of the asset, expense or income) arises only when the entity pays or receives advance consideration that gives rise to the recognition of a non-monetary prepayment asset or deferred income liability.

    (b) The underlying question relates to the appropriate recognition date for the purpose of applying paragraphs 21-22 of IAS 21. Nearly all respondents agreed with the Interpretations Committee's decision to broaden the scope of the draft Interpretation beyond revenue transactions.

Monetary and non-monetary items

18. Although respondents agree with the proposed scope of the draft Interpretation, a number of respondents raised a concern about the implied description of a non-monetary item in the draft Interpretation. Specifically, many respondents asked if Illustrative Examples 2 and 4 of the draft Interpretation indicated that 'non-cancellable' and 'non-refundable' are distinguishing features of a non-monetary item.[3]

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[2] Kim Chiu Chua (CL41).

[3] Hong Kong Institute of Certified Public Accountants (CL4), South African Institute of Chartered Accountants (CL23), Deloitte (CL24), Mazars (CL35), BUSINESSEUROPE (CL38), Institute of Singapore Chartered Accountants (CL42), Nestle (CL43).

19. Some respondents suggest that the Interpretation Committee should clarify whether 'non-cancellable' and 'non-refundable' are distinguishing feature of a non-monetary item. Because the draft Interpretation applies only to non-monetary items, this clarification is important in determining whether a transaction is within the scope of the Interpretation.

20. Comments from respondents regarding the description of a non-monetary item include:

    (a) One respondent noted that paragraph AG11 of IAS 32 *Financial Instruments: Presentation* explains that prepaid expenses and deferred revenue are not financial assets and financial liabilities, because the associated future economic benefit is not the right to receive, or contractual obligation to pay, cash or another financial asset.[4] This respondent suggests that such prepayments are non-monetary items, whether or not the consideration is refundable.

    (b) One respondent suggested that, because of the judgement that is sometimes required to determine whether an item is non-monetary, it would be helpful if the Interpretations Committee acknowledged in the Basis for Conclusions the need for judgement in determining which items are non-monetary.[5]

Meaning of paragraph 5(b)

21. Paragraph 5 of the draft Interpretation excludes from the scope of the Interpretation circumstances in which an entity is required to initially recognise the related asset, expense or income at:

    (a) its fair value; or

    (b) the fair value of the consideration given or received, if that consideration is measured in the foreign currency at a date other than the date of initial recognition of the related prepayment asset or deferred income liability.

[4] Australian Accounting Standards Board (CL12).

[5] EY (CL13).

22. Some of the large accounting firms think that it is unclear which (if any) IFRS Standards require measurement on initial recognition as specified in paragraph 5(b) of the draft Interpretation. They asked the Interpretations Committee to include an example of such a transaction or clarify the meaning of the phrase 'that consideration is measured in the foreign currency' in paragraph 5(b). Without further clarity, the firms are concerned that divergent practice might arise because of differing views on this paragraph.

Other issues on scope

23. Respondents raised several other issues about the scope of the draft Interpretation, as follows:

    (a) Embedded derivatives—one respondent noted that embedded foreign currency derivatives have not been addressed in the draft Interpretation.[6]

    (b) Scope exclusion—two respondents disagreed with the proposed optional application of the draft Interpretation to insurance contracts and income taxes.[7] These respondents think that the scope of the Interpretation should be consistent with that of IAS 21, because it is an interpretation of the requirements in that Standard.

    (c) Clarification of scope—some respondents suggested that the examples included in paragraph BC10 should, instead, be included in the text of the Interpretation.[8]

    (d) Presentation in the financial statements—one respondent raised a concern that the draft Interpretation does not cover the presentation of prepayments and deferred income liabilities in the balance sheet.[9]

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[6] PwC (CL26).

[7] Australian Accounting Standards Board (CL12), The Japanese Institute of Certified Public Accountants (CL33).

[8] ACTEO/AFEP/MEDEF (CL18), Business Europe (CL38).

[9] Nestlé (CL43).

Consensus of the draft Interpretation

General feedback on the consensus

24. Nearly all respondents supported the proposed consensus of the draft Interpretation. Those supporting the consensus think that it provides an appropriate interpretation of IAS 21 and will help to reduce diversity in practice. Specifically, they agreed with the following points:

    (a) The application of the 'one-transaction' approach, with the embedded notion that purchases and sales are exchange transactions in which payments and transfers of goods or services are inherently interdependent. In addition to this, one respondent noted that the one-transaction approach is consistent with the concept of hedge accounting for foreign currency risk.[10]

    (b) The consensus is consistent with the classification of prepayment assets and deferred income liabilities as non-monetary items. This is because, applying IAS 21, an entity does not subsequently retranslate such items.

    (c) The consensus reflects that an entity is no longer exposed to foreign exchange risk in respect of the transaction to the extent that it has received or paid any advance consideration.

Transaction with a significant financing component

25. Paragraphs 60-65 of IFRS 15 require that in determining the transaction price, an entity adjusts the consideration for the effects of the time value of money if the contract provides the customer or the entity with a significant benefit of financing—ie the contract contains a significant financing component.

26. Foreign currency consideration paid or received in advance can contain a significant financing component. However, the draft Interpretation does not specifically address which exchange rate(s) should be used to identify and report a significant financing

[10] Institute of Singapore Chartered Accountants (CL42).

component. The Accounting and Auditing Institute of Spain (CL10) noted the following:

> The question is if an entity receives a prepayment asset from a customer and the transfer of control occurs in more than one year term, IFRS 15 establishes a presumption that the transaction involves a significant financial component and therefore the standard requires updating the prepayment asset. Well, assuming that the payment has been received in foreign currency, in line with the interpretation of IFRIC, ICAC does not see clearly what exchange rate should be used to perform the update.

27. A number of respondents commented on this issue and most of them think that the draft Interpretation should address transactions with a significant financing component as described in IFRS 15.

Other issues on the consensus

28. Although understanding the rationale for the one-transaction approach, two respondents highlight that the draft Interpretation would result in the recognition of different amounts of revenue if advance consideration is paid on different dates or in different currencies, even though the contract values may be the same.[11] They view that as possibly conflicting with the principle in paragraph 46 in IFRS 15, in which an entity recognises revenue as and when it satisfies its performance obligation.

29. In addition, some respondents commented on the presentation of exchange differences in profit or loss, see paragraphs BC32-BC33 of the draft Interpretation. Most of these respondents agree with the rationale set out in BC32-BC33 that the issue is not relevant to the topic addressed in the draft Interpretation. However, Mazars (CL35) thinks that the Interpretation will be of limited benefit to users of financial statements if it remains unclear where to present foreign exchange differences on commercial contracts in the income statement.

[11] Accounting Standards Committee of Germany (CL21), BDO (CL44).

30. Respondents raised several other issues about the consensus of the draft Interpretation, as follows:

(a) Cost versus benefit—some respondents had reservations about the practical implementation challenges associated with the draft Interpretation, including updating ERP systems.[12] These respondents stated that most ERPs are based on a 'multiple transaction' approach. Consequently, they think that the proposals may create significant implementation costs.

(b) Example 4—some respondents raised a concern that Example 4 might be inappropriately understood to interpret the application of other Standards and Interpretations.[13] They propose that the Interpretations Committee either delete the example, or add a comment to the illustrative examples to clarify that the examples illustrate only the application of IAS 21.

(c) Request for additional examples—some respondents requested additional illustrative examples on non-cash advance consideration.[14]

(d) Exposure to foreign exchange risk—one respondent noted that the principle in paragraph 25 of the Basis for Conclusions to the draft Interpretation is not applied consistently in the proposals.[15] This respondent noted that if an entity were to recognise a contract liability when payment is due from a customer applying paragraph 106 of IFRS 15, the entity would remain exposed to foreign exchange risk until the payment is received. In this respondent's view, this contradicts paragraph BC25(a) of the draft Interpretation, which states that applying the one-transaction approach reflects that an entity is no longer exposed to foreign exchange risk in respect of the transaction.

[12] Mazars (CL35), SwissHoldings (CL37).

[13] South African Institute of Chartered Accountants (CL23), Deloitte (Cl24), KPMG (CL25), PwC (CL26)

[14] Mazars (CL35), The Indonesian Financial Account Standard Board (CL39), Nestle (CL43).

[15] Mazars (CL35).

Transition

General feedback on transition

31. There was wide support for the transition requirements in the draft Interpretation. Although many respondents acknowledged that full retrospective application enhances comparability and consistency in financial statements, respondents supported the Interpretations Committee's view that retrospective transition might place a considerable burden on some entities. In addition, entities may not have sufficient information, especially when restating transactions with many receipts or payments that had been recognised over a period of time.

32. Some respondents did not agree with the proposed transition requirements. Although they generally support the proposal to give entities the option of relief from retrospective application of the Interpretation, they suggest that a single date should be specified for prospective application in order to enhance comparability between entities.

Other issues on transition

33. Some respondents raised other concerns about transition, which include the following:

    (a) The transition approach proposed in the draft Interpretation could be complex. One respondent recommended that entities be permitted to apply the requirements of the Interpretation only to items for which the payment or receipt of foreign currency cash occurs after a specific date.[16]

    (b) One respondent proposed that the Interpretations Committee explicitly consider the interaction of the proposed transitional reliefs with the transition requirements of IFRS 15, which will lead to retrospective adjustments to deferred income liabilities (ie accelerated or delayed revenue recognition would have a corresponding effect on deferred income liabilities).[17]

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[16] Deloitte (CL24)

[17] EY (CL13)

(c) Two respondents asked for clarity about the accounting applying the alternative transition methods in paragraphs A2(b) and A3—in particular, in a situation in which an entity recognises (i) a prepayment asset or deferred income liability before the date specified in paragraph A2(b), and (ii) the related asset, expense or income afterwards.[18] In that scenario, those respondents think that it is unclear whether the exchange rate applied to the prepayment asset or deferred income liability is the rate on the date of payment or the date specified in paragraph A2(b).

(d) Two respondents noted that the package of proposed transition requirements has no precedent in other Standards. They also think that the proposed requirements contradict the notion that transactions occurring before a change becomes effective should not be restated, if the change has not been applied retrospectively.[19]

First-time adopters

34. Paragraphs BC36-BC37 note that the Interpretations Committee decided not to provide the transition relief for first-time adopters. This is because IFRS 1 *First-time Adoption of International Financial Reporting Standards* already contains an election to measure property, plant and equipment, investment property or intangible assets at the date of transition to IFRS Standards at fair value, and use that fair value as its deemed cost.

35. However, two respondents raise a concern that the burden of applying the draft Interpretation may be significantly different between existing IFRS entities and first-time adopters.[20] They note that existing IFRS entities can choose prospective application of the draft Interpretation. However, to avoid full retrospective application, first-time adopters have only the fair value option, which could possibly lead to undue cost or effort.

[18] Grant Thornton (CL7), Deloitte (CL24).

[19] Singapore Accounting Standards Council (CL16), South African Institute of Chartered Accountants (CL23).

[20] Grant Thornton (CL7), The Japanese Institute of Certified Public Accountants (CL33).

Effective date

36. Although the Interpretation Committee did not request comments on the effective date of the Interpretation, five respondents commented on it. Some of those respondents proposed that the effective date of the final Interpretation should be aligned with the effective date of IFRS 15. This is because many of the transactions that will be affected by the Interpretation are within the scope of IFRS 15. In their view, aligning the effective date would minimise any implementation costs. In contrast, the Australian Accounting Standards Board (AASB) (CL12) did not consider it necessary to align the effective date of the Interpretation with that of IFRS 15 because the Interpretation interprets IAS 21.

37. Other respondents proposed that the effective date of the final Interpretation should not be less than 12 month after its publication in order to provide time to implement the changes.[21]

Editorial

38. Several respondents suggested a number of editorial improvements to the draft Interpretation. Most of them are minor, eg clarifications of the wordings in the draft Interpretation, a referencing issue between the Standard and the draft Interpretation, rephrasing of the words, etc. However, we note one comment from the AASB (CL12) on the use of 'deferred income liability':

> The draft Interpretation introduces the terminology deferred income liability, but also uses the IFRS 15 defined term contract liability (for example, in Illustrative Examples 2 and 4 and paragraph BC27). The AASB thinks that it would be preferable for the same term to be used throughout the final Interpretation. In addition, the AASB supports the use of consistent terminology between IFRS, where possible. If the Committee thinks it is necessary for the Interpretation to continue to use the terminology 'deferred income liability', the AASB encourages the Committee to include its rationale for

[21] SwissHoldings (CL37), Nestle (CL43).

doing so in its Basis for Conclusions to the Interpretation, including how it differs from contract liability.

Question for the Interpretations Committee
Does the Interpretations Committee have any comments or questions on the matters set out in this paper?

Appendix A—List of Comment Letter respondents

CL #	Respondent	Region	Entity type
1	Brazilian Committee for Accounting Pronouncements	Latin America	Standard-setting body
2	Ana Diaz	-	Individual
3	Confederation of Swedish Enterprise	Europe	Preparer/Representative body
4	Hong Kong Institute of Certified Public Accountants	Asia	Standard-setting body
5	Israel Accounting Standards Board	Asia	Standard-setting body
6	The Institute of Public Accountants (Australia)	Oceania	Accountancy body
7	Grant Thornton International	Global	Accounting firm
8	The Malaysian Institute of Certified Public Accountants	Asia	Accountancy body
9	The Institute for the Accountancy Profession in Sweden (FAR)	Europe	Accountancy body
10	Accounting and Auditing Institute of Spain	Europe	Standard-setting body
11	The Korean Institute of Certified Public Accountants	Asia	Accountancy body
12	Australian Accounting Standards Board	Oceania	Standard-setting body
13	EY	Global	Accounting firm
14	RSM International	Global	Accounting firm
15	ESMA	Europe	Regulator/Securities
16	Singapore Accounting Standards Council	Asia	Standard-setting body
17	Zeenat Chisti	-	Individual

CL #	Respondent	Region	Entity type
18	ACTEO/AFEP/MEDEF	Europe	Preparer/Representative body
19	Canadian Accounting Standards Board	North America	Standard-setting body
20	Malaysian Accounting Standards Board	Asia	Standard-setting body
21	Accounting Standards Committee of Germany	Europe	Standard-setting body
22	Ms Lynessa Dias	North America	Individual
23	South African Institute of Chartered Accountants	Africa	Accountancy body
24	Deloitte Touche Tohmatsu Limited	Global	Accounting firm
25	KPMG IFRG Limited	Global	Accounting firm
26	PwC	Global	Accounting firm
27	GLASS	Latin America	Standard-setting body
28	REPSOL	Europe	Preparer/Industry
29	Banco Bradesco	Latin America	Preparer/Industry
30	Telefónica, S.A.	Europe	Preparer/Industry
31	CINIF (Mexico)	Latin America	Standard-setting body
32	Korea Accounting Standards Board	Asia	Standard-setting body
33	The Japanese Institute of Certified Public Accountants	Asia	Accountancy body
34	Federation of Accounting Professions (Thailand)	Asia	Accountancy body
35	Mazars	Global	Accounting firm
36	Zambia Institute of Chartered Accountants	Africa	Accountancy body
37	SwissHoldings	Europe	Preparer/Representative body
38	BUSINESSEUROPE	Europe	Preparer/Representative body
39	The Indonesian Financial Account Standard Board	Asia	Standard-setting body

CL #	Respondent	Region	Entity type
40	Norwegian Accounting Standards Board	Europe	Standard-setting body
41	Kim Chiu Chua	Asia	Individual
42	Institute of Singapore Chartered Accountants	Asia	Accountancy body
43	Nestle	Europe	Preparer/Industry
44	BDO	Global	Accounting firm
45	European Financial Reporting Advisory Group (EFRAG)	Europe	Standard-setting body[22]

[22] EFRAG provides advice to the European Commission on whether IFRS Standards and Interpretations meet the IAS Regulation endorsement criteria for use in the preparation of accounts in the EU. For the purpose of the analysis in this paper, EFRAG is classified as a standard-setter.

Statistical Summary of Comment Letters

Chart 1: Comment letters by geographical region

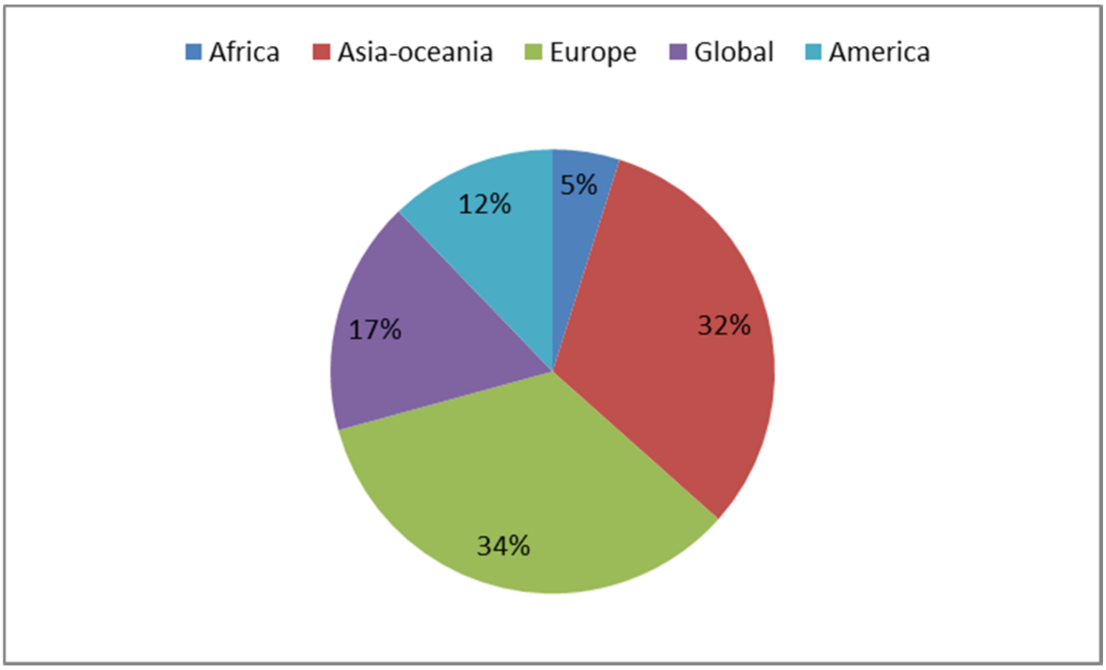

Chart 2: Comment letters by type of respondent