IFRIC Update November 2019

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings.

The Committee met in London on 26 November 2019, and discussed:

Committee's tentative agenda decisions

- Player Transfer Payments (IAS 38 *Intangible Assets*)—Agenda Paper 6
- Multiple Tax Consequences of Recovering an Asset (IAS 12 *Income Taxes*)—Agenda Paper 7

Committee's agenda decisions

- Lease Term and Useful Life of Leasehold Improvements (IFRS 16 *Leases* and IAS 16 *Property, Plant and Equipment*)—Agenda Paper 4

Items on the current agenda

- Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 5

Other matters

- 2020 Agenda Consultation—Agenda Papers 2–2D
- Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12—Agenda Paper 3
- Work in Progress—Agenda Paper 8

Related information

Next scheduled IFRS Interpretations Committee meeting:

- 21 January 2020

Interpretations Committee open items

For further information about IFRS Interpretations Committee activities including how to receive future IFRIC *Updates* follow the Interpretations Committee group page.

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add them to its standard-setting agenda. The Committee will reconsider these tentative decisions, including the reasons for not adding the matters to its standard-setting agenda, at a future meeting. The Committee invites comments on its tentative agenda decisions. Interested parties may submit comments on the open for comment page by 14 February 2020. All comments will be on the public record and posted on our website unless a responder requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by good reason, for example, commercial confidence. The Committee will consider all comments received in writing by 14 February 2020; agenda papers analysing comments received will include analysis only of comments received by that date.

Player Transfer Payments (IAS 38 *Intangible Assets*)—Agenda Paper 6

The Committee received a request about the recognition of player transfer payments received. In the fact pattern described in the request:

a. a football club (entity) transfers a player to another club (receiving club). When the entity recruited the player, the entity registered the player in an electronic transfer system. Registration means the player is prohibited from playing for another club, and requires the registering club to have an employment contract with the player that prevents the player from leaving the club without mutual agreement. Together the employment contract and registration in the electronic transfer system are referred to as a 'registration right'.
b. the entity had recognised costs incurred to obtain the registration right as an intangible asset applying IAS 38. The entity uses and develops the player through participation in matches, and then potentially transfers the player to another club. The entity views the development and transfer of players as part of its ordinary activities.
c. the entity and the receiving club enter into a transfer agreement under which the entity receives a transfer payment from the receiving club. The transfer payment compensates the entity for releasing the player from the employment contract. The registration in the electronic transfer system is not transferred to the receiving club but, legally, is extinguished when the receiving club registers the player and obtains a new right.
d. the entity derecognises its intangible asset upon the receiving club registering the player in the electronic transfer system.

The request asked whether the entity recognises the transfer payment received as revenue applying IFRS 15 *Revenue from Contracts with Customers* or, instead, recognises the gain or loss arising from the derecognition of the intangible asset in profit or loss applying IAS 38.

Recognition of transfer payment received

In the fact pattern described in the request, the entity classified the registration right as an intangible asset applying IAS 38. Accordingly, the entity applies the derecognition requirements in IAS 38 on derecognition of that right.

Paragraph 113 of IAS 38 states that 'the gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised…Gains shall not be classified as revenue'. Applying that paragraph, the entity recognises in profit or loss, but not as revenue, the difference between the net disposal proceeds and the carrying amount of the registration right.

Does the transfer payment represent disposal proceeds?

The transfer payment arises from the transfer agreement, which requires the entity to release the player from the employment contract. The entity is therefore required to undertake some action for the right to be extinguished; the right does not expire or dissipate. Accordingly, the transfer payment compensates the entity for its action in disposing of the registration right and, thus, is part of the net disposal proceeds described in paragraph 113 of IAS 38.

The Committee concluded that, in the fact pattern described in the request, the entity recognises the transfer payment received as part of the gain or loss arising from the derecognition of the registration right applying paragraph 113 of IAS 38. In the fact pattern described in the request (in which the entity recognises the registration right as an intangible asset), the entity does not recognise the transfer payment received, or any gain arising, as revenue applying IFRS 15.

Is there a circumstance in which the entity would recognise the transfer payment received as revenue applying IFRS 15?

Paragraph 2 of IAS 2 *Inventories* requires an entity to apply IAS 2 to intangible assets that meet the definition of inventories. In the fact pattern described in the request, the entity has concluded that the registration right does not meet the definition of inventories and, accordingly, has applied IAS 38 in accounting for that right.

If the registration right were to meet the definition of inventories, the entity would apply IAS 2 in accounting for the right and, on disposal, apply the derecognition requirements of that Standard. Paragraph 34 of IAS 2 states that 'when inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised'. Had the entity classified the registration right as inventories, the entity would apply IFRS 15 in accounting for the transfer payment received (as long as the transfer agreement were within the scope of IFRS 15).

Paragraph 6 of IAS 2 defines inventories as 'assets: (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services'. IAS 40 *Investment Property* also specifies that inventories include property in the process of construction or development for sale in the ordinary course of business.

The Committee observed that, for an entity whose ordinary activities include the development and transfer of players, it is conceivable that circumstances exist in which registration rights associated with some players meet the definition of inventories. In applying that definition, on initial recognition such an entity would consider whether the registration right is acquired for development and sale in the ordinary course of business. The Committee noted that whether a registration right meets the definition of inventories requires an assessment of the facts and circumstances.

Statement of cash flows

IAS 7 *Statement of Cash Flows* lists cash receipts from sales of intangibles as an example of cash flows arising from investing activities. IAS 7 also lists cash receipts from revenue as examples of cash flows arising from operating activities.

Accordingly, an entity presents cash receipts from transfer payments:

a. as part of investing activities if it had recognised the registration right as an intangible asset; or

b. as part of operating activities if it had recognised the registration right as inventories and the transfer payment received as revenue.

Disclosure of accounting policies

Paragraphs 117 and 122 of IAS 1 *Presentation of Financial Statements* require an entity to disclose significant accounting policies, and the judgements management has made in the process of applying accounting policies that have the most significant effect on the amounts recognised in the financial statements. The Committee observed that, for a football club, such disclosures are likely to include accounting policies in relation to the classification of registration rights and the recognition of transfer payments received.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for the entity to determine the recognition of player transfer payments received. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Multiple Tax Consequences of Recovering an Asset (IAS 12 *Income Taxes*)—Agenda Paper 7

The Committee received a request about deferred tax when the recovery of the carrying amount of an asset gives rise to multiple tax consequences. In the fact pattern described in the request:

a. an entity acquires an intangible asset with a finite useful life (a licence) as part of a business combination. The carrying amount of the licence at initial recognition is CU100. The entity intends to recover the carrying amount of the licence through use, and the expected residual value of the licence at expiry is nil.
b. the applicable tax law prescribes two tax regimes: an income tax regime and a capital gains tax regime. Tax paid under both regimes meets the definition of income taxes in IAS 12. Recovering the licence's carrying amount through use has both of the following tax consequences:
    i. under the income tax regime—the entity pays income tax on the economic benefits it receives from recovering the licence's carrying amount through use, but receives no tax deductions in respect of amortisation of the licence (taxable economic benefits from use); and
    ii. under the capital gains tax regime—the entity receives a tax deduction of CU100 when the licence expires (capital gain deduction).
c. the applicable tax law prohibits the entity from using the capital gain deduction to offset the taxable economic benefits from use in determining taxable profit.

The request asked how the entity determines the tax base of the asset and, consequently, how it accounts for deferred tax.

The fundamental principle in IAS 12

Paragraph 10 of IAS 12 states that 'where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Standard is based'. The same paragraph describes, as that fundamental principle, 'that an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences'.

Applying the fundamental principle to the fact pattern

The Committee observed that, in the fact pattern described in the request, the tax base of the asset is not immediately apparent. The Committee also observed that the recovery of the asset's carrying amount gives rise to two distinct tax consequences—it results in taxable economic

benefits from use and a capital gain deduction that cannot be offset in determining taxable profit. Accordingly, applying the fundamental principle in IAS 12, an entity reflects separately the distinct tax consequences of recovering the asset's carrying amount.

An entity identifies temporary differences in a manner that reflects these distinct tax consequences by comparing:

a. the portion of the asset's carrying amount that will be recovered under one tax regime; to
b. the tax deductions that will be received under that same tax regime (which are reflected in the asset's tax base).

In the fact pattern described in the request, the Committee concluded that the entity identifies both:

a. a taxable temporary difference of CU100—the entity will recover the licence's carrying amount (CU100) under the income tax regime, but will receive no tax deductions under that regime (that is, none of the tax base relates to deductions under the income tax regime); and
b. a deductible temporary difference of CU100—the entity will not recover any part of the licence's carrying amount under the capital gains tax regime, but will receive a deduction of CU100 upon expiry of the licence (that is, all of the tax base relates to deductions under the capital gains tax regime).

The entity then applies the requirements in IAS 12 considering the applicable tax law in recognising and measuring deferred tax for the identified temporary differences.

The Committee concluded that the principles and requirements in IAS 12 provide an adequate basis for an entity to account for deferred tax in the fact pattern described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Committee's agenda decisions

The process for publishing an agenda decision might often result in explanatory material that provides new information that was not otherwise available and could not otherwise reasonably have been expected to be obtained. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision. The Board expects that an entity would be entitled to sufficient time to make that determination and implement any change (for example, an entity may need to obtain new information or adapt its systems to implement a change).

The Committee discussed the following matters and decided not to add them to its standard-setting agenda.

Lease Term and Useful Life of Leasehold Improvements (IFRS 16 *Leases* and IAS 16 *Property, Plant and Equipment*)—Agenda Paper 4

The Committee received a request about cancellable or renewable leases.

The cancellable lease described in the request is one that does not specify a particular contractual term but continues indefinitely until either party to the contract gives notice to terminate. The contract includes a notice period of, for example, less than 12 months and the contract does not oblige either party to make a payment on termination. The renewable lease described in the request is one that specifies an initial period, and renews indefinitely at the end of the initial period unless terminated by either of the parties to the contract.

The request asked two questions:

a. how to determine the lease term of a cancellable lease or a renewable lease. Specifically, the request asked whether, when applying paragraph B34 of IFRS 16 and assessing 'no more than an insignificant penalty', an entity considers the broader economics of the contract, and not only contractual termination payments. Such considerations might include, for example, the cost of abandoning or dismantling leasehold improvements.

b. whether the useful life of any related non-removable leasehold improvements is limited to the lease term determined applying IFRS 16. Non-removable leasehold improvements are, for example, fixtures and fittings acquired by the lessee and constructed on the underlying asset that is the subject of the cancellable or renewable lease. The lessee will use and benefit from the leasehold improvements only for as long as it uses the underlying asset.

Lease term

Paragraph 18 of IFRS 16 requires an entity to determine the lease term as the non-cancellable period of a lease, together with both (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

In determining the lease term and assessing the length of the non-cancellable period of a lease, paragraph B34 of IFRS 16 requires an entity to determine the period for which the contract is enforceable. Paragraph B34 specifies that 'a lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty'.

Paragraph BC156 sets out the Board's view that 'the lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used because that approach provides the most useful information'.

The Committee observed that, in applying paragraph B34 and determining the enforceable period of the lease described in the request, an entity considers:

a. the broader economics of the contract, and not only contractual termination payments. For example, if either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination that is more than insignificant, the contract is enforceable beyond the date on which the contract can be terminated; and
b. whether each of the parties has the right to terminate the lease without permission from the other party with no more than an insignificant penalty. Applying paragraph B34, a lease is no longer enforceable only when both parties have such a right. Consequently, if only one party has the right to terminate the lease without permission from the other party with no more than an insignificant penalty, the contract is enforceable beyond the date on which the contract can be terminated by that party.

If an entity concludes that the contract is enforceable beyond the notice period of a cancellable lease (or the initial period of a renewable lease), it then applies paragraphs 19 and B37–B40 of IFRS 16 to assess whether the lessee is reasonably certain not to exercise the option to terminate the lease.

Useful life of non-removable leasehold improvements

Paragraph 50 of IAS 16 requires an item of property, plant and equipment (asset) to be depreciated over its useful life.

IAS 16 defines the useful life of an asset as (emphasis added) '*the period over which an asset is expected to be available for use by an entity*; or the number of production or similar units expected to be obtained from the asset by an entity'.

Paragraphs 56 and 57 of IAS 16 provide further requirements on the useful life of an asset. In particular, paragraph 56(d) specifies that in determining the useful life of an asset, an entity considers any 'legal or similar limits on the use of the asset, such as the expiry dates of related leases'. Paragraph 57 specifies that the useful life of an asset 'is defined in terms of the asset's expected utility to the entity', and 'may be shorter than its economic life'.

An entity applies paragraphs 56–57 of IAS 16 in determining the useful life of non-removable leasehold improvements. If the lease term of the related lease is shorter than the economic life of those leasehold improvements, the entity considers whether it expects to use the leasehold improvements beyond that lease term. If the entity does not expect to use the leasehold improvements beyond the lease term of the related lease then, applying paragraph 57 of IAS 16, it concludes that the useful life of the non-removable leasehold improvements is the same as the lease term. The Committee observed that, applying paragraphs 56–57 of IAS 16, an entity might often reach this conclusion for leasehold improvements that the entity will use and benefit from only for as long as it uses the underlying asset in the lease.

Interaction between lease term and useful life

In assessing whether a lessee is reasonably certain to extend (or not to terminate) a lease, paragraph B37 of IFRS 16 requires an entity to consider all relevant facts and circumstances that create an economic incentive for the lessee. This includes significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when an option to extend or terminate the lease becomes exercisable (paragraph B37(b)).

In addition, as noted above an entity considers the broader economics of the contract when determining the enforceable period of the lease described in the request. This includes, for example, the costs of abandoning or dismantling non-removable leasehold improvements. If an entity expects to use non-removable leasehold improvements beyond the date on which the contract can be terminated, the existence of those leasehold improvements indicates that the

entity might incur a more than insignificant penalty if it terminates the lease. Consequently, applying paragraph B34 of IFRS 16, an entity considers whether the contract is enforceable for at least the period of expected utility of the leasehold improvements.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine the lease term of cancellable and renewable leases. The Committee also concluded that the principles and requirements in IAS 16 and IFRS 16 provide an adequate basis for an entity to determine the useful life of any non-removable leasehold improvements relating to such a lease. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Items on the current agenda

Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 5

The Committee discussed a request about a sale and leaseback transaction for which the payments under the leaseback vary with sales. The Committee considered how, in the transaction described in the request, the seller-lessee measures the right-of-use asset arising from the leaseback, and thus determines the amount of any gain or loss recognised at the date of the transaction.

The Committee did not make any decisions and will continue its discussion of the matter at a future meeting.

Other matters

2020 Agenda Consultation—Agenda Papers 2–2D

Committee members provided suggestions for the Board to include in a list of potential projects in the Request for Information to be published as part of the 2020 Agenda Consultation.

The Board will consider these and other suggestions when it discusses the 2020 Agenda Consultation at a future Board meeting.

Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12—Agenda Paper 3

Committee members provided feedback on matters encountered when implementing and applying IFRS 10, IFRS 11 and IFRS 12.

The Board will consider this and other feedback as part of phase 1 of the post-implementation review of IFRS 10, IFRS 11 and IFRS 12.

Work in Progress—Agenda Paper 8

There are no new or ongoing matters that have not yet been presented to the Committee.