IFRIC Update September 2021

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings. Past *Update*s can be found in the IFRIC *Update* archive.

The Committee met on 14–15 September 2021, and discussed:

Committee's tentative agenda decisions

- Demand Deposits with Restrictions on Use (IAS 7 *Statement of Cash Flows*)—Agenda Paper 5
- Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9 *Financial Instruments*)—Agenda Paper 6

Agenda decisions for the Board's consideration

- Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 2
- Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 3

Other matters

- Lease Liability in a Sale and Leaseback—Agenda Paper 4
- Work in Progress—Agenda Paper 7

Addendum to IFRIC Update—Committee's agenda decisions

- Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 2
- Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 3

Related information

The work plan

Supporting consistent application

Committee’s tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add standard-setting projects to the work plan. The Committee will reconsider these tentative decisions, including the reasons for not adding standard-setting projects, at a future meeting. The Committee invites comments on the tentative agenda decisions. Interested parties may submit comments on the open for comment page. All comments will be on the public record and posted on our website unless a respondent requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. The Committee will consider all comments received in writing up to and including the closing date; comments received after that date will not be analysed in agenda papers considered by the Committee.

Demand Deposits with Restrictions on Use (IAS 7 *Statement of Cash Flows*)—Agenda Paper 5

The Committee received a request about whether an entity includes a demand deposit as a component of cash and cash equivalents in its statements of cash flows and financial position when the demand deposit is subject to contractual restrictions on use agreed with a third party. In the fact pattern described in the request, the entity:

a. holds a demand deposit whose terms and conditions do not prevent the entity from accessing the amounts held in it (that is, were the entity to request any amount from the deposit, it would receive that amount on demand).
b. has a contractual obligation with a third party to keep a specified amount of cash in that separate demand deposit and to use the cash only for specified purposes. If the entity were to use the amounts held in the demand deposit for purposes other than those agreed with the third party, the entity would be in breach of its contractual obligation.

Cash and cash equivalents in the statement of cash flows

Paragraph 6 of IAS 7 defines ‘cash’ by stating that it ‘comprises cash on hand and demand deposits.’ IAS 7 includes no other requirements on whether an item qualifies as cash beyond the definition itself.

IAS 7 and IAS 1 *Presentation of Financial Statements* indicate that amounts included in cash and cash equivalents may be subject to restrictions. Namely:

a. paragraph 48 of IAS 7 requires an entity to disclose information about ‘significant cash and cash equivalent balances held by the entity that are not available for use by the group’; and
b. paragraph 66(d) of IAS 1 requires an entity to classify as current an asset that is ‘cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period’.

The Committee concluded that restrictions on use of a demand deposit arising from a contract with a third party do not result in the deposit no longer being cash, unless those restrictions change the nature of the deposit in a way that it would no longer meet the definition of cash in IAS 7.

In the fact pattern described in the request, the contractual restrictions on use of the amounts held in the demand deposit do not change the nature of the deposit—the entity can access those amounts on demand. The Committee therefore concluded that the entity includes the demand deposit as a component of 'cash and cash equivalents' in its statement of cash flows.

Presentation in the statement of financial position

Paragraph 54(i) of IAS 1 requires an entity to include a line item in its statement of financial position that presents the amount of 'cash and cash equivalents'. Paragraph 55 of IAS 1 states 'an entity shall present additional line items (including by disaggregating the line items listed in paragraph 54) … in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position'.

The Committee therefore concluded that, in the fact pattern described in the request, the entity presents the demand deposit as cash and cash equivalents in its statement of financial position. When relevant to an understanding of its financial position, the entity would disaggregate the cash and cash equivalents line item and present the demand deposit subject to contractual restrictions on use separately in an additional line item.

An entity that presents assets as current or non-current would, applying paragraph 66(d) of IAS 1, classify the demand deposit as current unless the deposit is 'restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period'.

Disclosures

Paragraph 45 of IAS 7 states that 'an entity shall disclose the components of cash and cash equivalents…', and paragraph 48 of IAS 7 requires an entity to disclose, together with commentary by management, 'the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group'. Applying those requirements, the entity discloses the demand deposit subject to contractual restrictions on use as a component of cash and cash equivalents and the amount of significant cash and cash equivalent balances unavailable for use by the group, as well as information about that amount. The entity also considers whether to disclose additional information:

a. in the context of the requirements in IFRS 7 *Financial Instruments: Disclosures* about liquidity risk arising from financial instruments and how an entity manages that risk; and
b. if the information it provides applying the disclosure requirements in IAS 7 and IFRS 7 is insufficient to enable users of financial statements to understand the impact of the restrictions on the entity's financial position (paragraph 31 of IAS 1).

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine whether to include demand deposits subject to contractual restrictions on use agreed with a third party as a component of cash and cash equivalents in its statements of cash flows and financial position. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9 *Financial Instruments*)—Agenda Paper 6

The Committee received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset. In the fact pattern described in the request:

a. the electronic transfer system has an automated settlement process that takes three working days to settle a cash transfer. All cash transfers made via the system are therefore settled (deposited in the recipient's bank account) two working days after they are initiated by the payer.
b. an entity has a trade receivable with a customer. At the entity's reporting date, the customer has initiated a cash transfer via the electronic transfer system to settle the trade receivable. The entity receives the cash in its bank account two days after its reporting date.

The request asked whether the entity can derecognise the trade receivable and recognise cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is settled (after its reporting date).

The applicable requirements in IFRS 9

The fact pattern described in the request involves the receipt of cash as settlement for a trade receivable. Both the trade receivable, and the cash the entity receives, are financial assets within the scope of IFRS 9. The entity therefore applies paragraph 3.2.3 of IFRS 9 in determining the date on which to derecognise the trade receivable and paragraph 3.1.1 of IFRS 9 in determining the date on which to recognise the cash as a financial asset.

The Committee observed that, in the fact pattern described in the request, the entity is neither purchasing nor selling a financial asset. Therefore, paragraph 3.1.2 of IFRS 9—which specifies requirements for a regular way purchase or sale of a financial asset—is not applicable.

Derecognition of the trade receivable

Except when an entity transfers a financial asset, paragraph 3.2.3 of IFRS 9 requires an entity to derecognise a financial asset when, and only when, 'the contractual rights to the cash flows from the financial asset expire'. In the fact pattern described in the request, the entity therefore derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire.

Determining the date on which the entity's contractual rights to those cash flows expire is a legal matter, which would depend on the specific facts and circumstances including the applicable laws and regulations and the characteristics of the electronic transfer system. In the fact pattern described in the request, if the entity's contractual right to receive cash from the customer expires only when the cash is received, the entity would derecognise the trade receivable on the transfer settlement date (the date it receives the cash in its bank account).

Recognition of cash (or another financial asset)

Paragraph 3.1.1 of IFRS 9 requires an entity to recognise a financial asset when, and only when, 'the entity becomes party to the contractual provisions of the instrument'. In the fact pattern described in the request, the entity is party to the contractual provisions of an instrument—its bank account—under which it has the contractual right to obtain cash from the bank for amounts it has deposited with that bank. In the fact pattern described in the request, it is therefore only when cash is deposited in its bank account that the entity would have a right to obtain cash from the bank. Consequently, the entity recognises cash as a financial asset on the transfer settlement date, and not before.

The Committee observed that, if an entity's contractual rights to the cash flows from the trade receivable expire before the transfer settlement date, the entity would recognise any financial asset received as settlement for the trade receivable (for example, a right to receive cash from the customer's bank) on that same date. An entity would not however recognise cash (or another financial asset) received as settlement for a trade receivable before it derecognises the trade receivable.

Conclusion

In the fact pattern described in the request, the Committee concluded that, applying paragraphs 3.2.3 and 3.1.1 of IFRS 9, the entity:

a. derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and
b. recognises the cash (or another financial asset) received as settlement for that trade receivable on the same date.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine when to derecognise a trade receivable and recognise cash received via an electronic transfer system as settlement for that receivable. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Agenda decisions for the Board's consideration

Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 2

The Committee considered feedback on the tentative agenda decision published in the March 2021 IFRIC *Update* about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments.

The Committee reached its conclusions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the International Accounting Standards Board (Board) will consider this agenda decision at its October 2021 meeting. If the Board does not object to the agenda decision, it will be published in October 2021 in an addendum to this IFRIC *Update*.

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 3

The Committee considered feedback on the tentative agenda decision published in the March 2021 IFRIC *Update* about the application of IAS 32 in relation to the reclassification of warrants.

The Committee reached its conclusions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the Board will consider this agenda decision at its October 2021 meeting. If the Board does not object to the agenda decision, it will be published in October 2021 in an addendum to this IFRIC *Update*.

Other matters

Lease Liability in a Sale and Leaseback—Agenda Paper 4

The Committee discussed the Board's Lease Liability in a Sale and Leaseback project. Committee members provided advice on the project's direction after considering the feedback on the related exposure draft.

The Board will consider the Committee's advice when it discusses the matter at a future meeting.

Work in Progress—Agenda Paper 7

The Committee received an update on the current status of open matters not discussed at its meeting in September 2021.

Addendum to IFRIC *Update*—Committee's agenda decisions

Agenda decisions, in many cases, include explanatory material. Explanatory material may provide additional insights that might change an entity's understanding of the principles and requirements in IFRS Standards. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision. It is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, an entity may need to obtain new information or adapt its systems to implement a change). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Standards.

The Committee discussed the following matters and decided not to add standard-setting projects to the work plan.

Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 2

Published in October 2021[1]

The Committee received a request about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. In the fact pattern described in the request:

a. the lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.
b. the applicable legislation:
    i. requires a seller to collect VAT and remit it to the government; and
    ii. generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.
c. because of the nature of its operations, the lessee can recover only a portion of the VAT charged on purchased goods or services. This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.
d. lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.

Outreach conducted by the Committee and comment letters on the Committee's tentative agenda decision provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and
b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

[1] In accordance with paragraph 8.7 of the *Due Process Handbook*, at its October 2021 meeting, the International Accounting Standards Board discussed, and did not object to, this agenda decision.

The Committee has therefore not received evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee decided not to add a standard-setting project to the work plan.

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 3

Published in October 2021[1]

The Committee received a request about the application of IAS 32 in relation to the reclassification of warrants. Specifically, the request described a warrant that provides the holder with the right to buy a fixed number of equity instruments of the issuer of the warrant for an exercise price that will be fixed at a future date. At initial recognition, because of the variability in the exercise price, the issuer in applying paragraph 16 of IAS 32 classifies these instruments as financial liabilities. This is because for a derivative financial instrument to be classified as equity, it must be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments ('fixed-for-fixed condition'). The request asked whether the issuer reclassifies the warrant as an equity instrument following the fixing of the warrant's exercise price after initial recognition as specified in the contract, given that the fixed-for-fixed condition would at that stage be met.

The Committee observed that IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged. The Committee acknowledged that similar questions about reclassification arise in other circumstances. Reclassification by the issuer has been identified as one of the practice issues the Board will consider addressing in its Financial Instruments with Characteristics of Equity (FICE) project. The Committee concluded that the matter described in the request is, in isolation, too narrow for the Board or the Committee to address in a cost-effective manner. Instead, the Board should consider the matter as part of its broader discussions on the FICE project. For these reasons, the Committee decided not to add a standard-setting project to the work plan.