IFRS Accounting

Staff paper

Agenda reference: 4

IFRS® Interpretations Committee meeting

Date	**November 2024**
Project	**Classification of Cash Flows related to Variation Margin Calls on 'Collateralised-to-Market' Contracts (IAS 7)**
Topic	**Comment letters on tentative agenda decision**
Contacts	Stefano Tampubolon (stampubolon@ifrs.org) Zhiqi Ni (zni@ifrs.org)

Introduction

1. At its June 2024 meeting, the IFRS Interpretations Committee (Committee) published a tentative agenda decision in response to a submission about how an entity presents, in the statement of cash flows, cash payments and receipts related to variation margin calls on contracts to purchase or sell commodities at a predetermined price at a specified time in the future. The contracts described in the submission are centrally cleared and 'collateralised-to-market' derivatives.

2. This paper:
   (a) provides a summary of the submission;
   (b) analyses comments on the tentative agenda decision; and
   (c) asks the Committee whether it agrees with our recommendation to finalise the agenda decision.

Structure

3. This paper includes:
   (a) background information;

(b) summary of the comment letters;

(c) staff analysis;

(d) staff recommendation and questions for the Committee.

4. The appendix to this paper sets out suggested wording for the agenda decision.

Background information

Summary of the submission

5. The submission describes a contract (that is, a derivative) to purchase or sell commodities, used in an entity's economic activities, at a predetermined price and at a specified time in the future.

6. An entity may enter into such a contract for different purposes and applies the relevant requirements in IFRS Accounting Standards. For example, the entity may use such a contract:

(a) *to receive commodities in accordance with its expected usage requirements*. The contract would be settled physically, and the entity could account for the contract by applying paragraph 2.4 of IFRS 9 *Financial Instruments* if it meets the 'own-use' exemption.[1]

(b) *to hedge against fluctuations in the prices of commodities*. The contract would be settled net in cash. The entity would account for the contract as a hedging instrument in a cash flow hedging relationship by applying the relevant requirements in IFRS 9.

[1] Paragraph 2.4 of IFRS 9 states: 'This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. …'

(c) *for trading purposes*.

Applying IFRS 9, the entity would classify the contract as a financial asset or a financial liability that is subsequently measured at fair value through profit or loss.

7. Such a contract typically has a maturity of up to three years and is both:

(a) *centrally cleared*—after a new contract is entered into, for the purpose of settlement via a central counterparty, the contract is novated by each counterparty to the central counterparty.

(b) *'collateralised-to-market'*—during the life of the contract, the counterparties make or receive daily payments based on the fluctuations of the fair value of the contract (variation margin call payments). These variation margin call payments represent a transfer of cash collateral (hence the contract is 'collateralised-to-market'), rather than a partial settlement of the contract (as in 'settled-to-market' contracts).

8. The contract can be settled physically or net in cash. At settlement, the cumulative collateral received during the life of the contract (that is, the variation margin call payments to date) is used for partial settlement of the contract. Therefore, if the contract is settled net in cash, the final payment at settlement reflects the difference between the fair value of the contract at the last variation margin call payment and the fair value of the contract at settlement.

9. The question in the submission focused only on the classification of cash flows related to variation margin call payments on the contract, and not the classification or measurement of the contract or variation margin itself, nor the presentation in the statement of financial position or statement of profit or loss.

10. The submission identified two alternative views, namely that the cash flows related to variation margin call payments on the contract:

(a) may be classified as cash flows from activities *other than operating* activities.

(b) should be classified as cash flows from *operating* activities.

The Committee's findings and conclusion

11. The responses to the Committee's information request on the matter described in the submission indicated that the matter was *not widespread*.[2] Therefore, the Committee concluded that the matter did not meet the criteria for adding a standard-setting project to the work plan set out in paragraph 5.16 of the *Due Process Handbook*. In particular, the matter did not meet the criterion in sub-paragraph 5.16(a) that 'the matter has widespread effect and has, or is expected to have, a material effect on those affected' ('widespread and material' criterion).

12. In the light of these findings, the Committee tentatively decided not to add a standard-setting project to the work plan. Instead, the Committee published a tentative agenda decision explaining its reasons for not adding a standard-setting project.

Summary of the comment letters

13. The Committee received nine comment letters by the comment letters deadline. All comment letters, including any received late, are available on our website.[3]

Support for the tentative agenda decision

14. Six respondents agree with the Committee's conclusion and tentative decision not to add a standard-setting project to the work plan. Of these respondents, four respondents—Deloitte, the Malaysian Accounting Standards Board, Mo Chartered Accountants and the Accounting & Auditing Advisory Committee of the Virginia Society of CPAs—provide no additional comments.

[2] Paragraphs 11–23 of Agenda Paper 3 for the June 2024 Committee meeting summarise the responses to the Committee's information request on the matter.

[3] At the date of posting this paper, there were two late comment letters.

15. The other two respondents provide the following comments:

    (a) Forvis Mazars says, although the contracts described in the tentative agenda decision are common, it has observed no widespread diversity. The respondent says cash flows related to variation margin calls on such contracts are usually classified as cash flows from *operating* activities.

    (b) the Group of Latin American Accounting Standards Setters (GLASS) says the principles in IAS 7 *Statement of Cash Flows* apply generally to any transaction and any type of entity. Therefore, in GLASS's view, it would be inappropriate for the Committee to conclude on how an entity would classify cash flows arising from a specific transaction.

Disagreement with the tentative agenda decision

16. Three respondents disagree with the Committee's conclusion that the matter does not meet the 'widespread and material' criterion.

17. Kariem Salah Srour says many entities that operate in hyperinflationary economies—or are exposed to significant foreign exchange rate fluctuations—often enter into such contracts and provide cash collaterals on those contracts. The respondent also says that, in their experience, cash flows relating to variation margin calls on such contracts would be classified as cash flows from *operating* activities.

18. Sounder Rajan says, because the submitter raised the matter for the Committee's consideration, it is likely that the matter *could* give rise to a material effect for the submitter, even though such contracts may *not* be widespread. Furthermore, the respondent says an accounting policy choice for classifying cash flows relating to variation margin calls on the contracts described in the submission could potentially lead to misstatements.

19. The European Securities and Markets Authority (ESMA) does not disagree with the Committee's tentative decision not to add a standard-setting project to the work plan.

However, ESMA disagrees with the Committee's decision to not include explanatory material in the tentative agenda decision.

20. In ESMA's view:

(a) responses to the information request indicate the significance of the matter. In particular, ESMA notes that most respondents said they have observed such contracts, and one of these respondents said entities generally do not provide detailed disclosures on those contracts.

(b) the question of how an entity classifies cash flows related to variation margin calls could also arise in the context of contracts that are *bilateral* and that have different maturities (as opposed to contracts referred to in the original fact pattern submitted—that are *centrally cleared* and with maturities of up to three years—as described in the tentative agenda decision).

21. In the light of their views:

(a) Kariem Salah Srour and Sounder Rajan suggest adding a standard-setting project to the work plan; and

(b) ESMA suggests that the Committee provide further clarification to the tentative agenda decision—particularly on:

(i) how an entity classifies cash flows relating to variation margin calls on contracts that are *bilateral* and have different maturities.

(ii) whether and, if so, how factors specific to a particular fact pattern could impact the classification of cash flows relating to variation margin calls.[4]

[4] ESMA refers to paragraph 27 of Agenda Paper 3 for the June 2024 Committee meeting which includes some of these factors, namely: '…differences in the underlying contractual terms, the contract duration, the purposes for which entities are using the contracts as well as differences in the business activities of entities. …'

Staff analysis

Suggestions to add a standard setting project to the work plan

22. We continue to agree with the Committee's conclusion that the criteria for adding a standard-setting project to the work plan set out in paragraph 5.16 of the *Due Process Handbook*—particularly the 'widespread and material' criterion—are not met.

23. We acknowledge the views expressed by:

    (a) Karim Salah Srour that many entities in hyperinflationary economies enter into such contracts (see paragraph 17 of this paper);

    (b) Sounder Rajan that the fact pattern *could* be material for the submitter (see paragraph 18 of this paper); and

    (c) ESMA that respondents to the information request said they have observed such contracts, and that one of these respondents said entities generally do not provide detailed disclosures on those contracts (see paragraph 20(a) of this paper.

24. However, assessing whether a matter has widespread effect requires considering not only whether the fact pattern or transaction described in the submission is prevalent, but also whether the existence of different views, and consequently, *diversity* in accounting for that fact pattern or transaction is widespread.

25. Feedback on the tentative agenda decision supports the Committee's conclusion, as neither these respondents nor other stakeholders expressed a view or provided evidence that there is widespread diversity that has (or could have) a material effect on those affected in their jurisdictions.

Suggestion to clarify the tentative agenda decision

26. The Committee's role is to respond to application questions asked to it. In our view, the Committee has already considered the question submitted—that is, given the fact pattern set out in the submission. The Committee should not consider other fact

patterns—such as those relating to contracts that are *bilateral* and have different maturities—that are not part of the submission. Neither the submission, the responses to the Committee's information request, nor the feedback on the tentative agenda decision indicate that widespread diversity relating to the classification of such cash flows could arise in other contexts.

27. We also think the Committee should not further analyse whether and, if so, how different factors specific to a particular fact pattern could impact the classification of cash flows relating to variation margin calls. In our view, such an analysis would amount to explanatory material.[5] Paragraph 8.3 of the *Due Process Handbook* states:

> … An agenda decision typically includes explanatory material when the reason for not adding a standard-setting project to the work plan is the Interpretations Committee's conclusion that the principles and requirements in the Standards provide an adequate basis for an entity to determine the required accounting. …

28. In this case, the Committee's reason for not adding a standard-setting project to the work plan is a different one—it is that the matter does not meet the 'widespread and material' criterion set out in paragraph 5.16(a) of the *Due Process Handbook*. In the past, the Committee similarly decided not to include explanatory material in agenda decisions for issues which did not meet the 'widespread and material' criterion.[6]

Staff recommendation and questions for the Committee

29. Based on our analysis in paragraphs 22–28 of this paper, we recommend finalising the agenda decision, with minor changes to the wording of the tentative agenda decision as marked in the appendix to this paper.

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[5] Paragraph 8.4 of the *Due Process Handbook* states: '…explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

[6] For example, see Agenda Decisions *Non-refundable Value Added Tax on Lease Payments* (IFRS 16 *Leases*) published in September 2021, *Homes and Home Loans Provided to Employees* published in September 2023 and *Merger between a Parent and Its Subsidiary in Separate Financial Statements* (IAS 27 *Separate Financial Statements*) published in January 2024.

30. If the Committee agrees with our recommendation, we will ask the International Accounting Standards Board (IASB) whether it objects to the agenda decision at the first IASB meeting at which it is practicable to present the agenda decision.

Questions for the Committee
1. Does the Committee agree with our recommendation set out in paragraph 29 of this paper? 2. Do Committee members have any comments on the wording of the agenda decision in the appendix to this paper?

Appendix—proposed wording of the agenda decision

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

Classification of Cash Flows related to Variation Margin Calls on 'Collateralised-to-Market' Contracts (IAS 7 *Statement of Cash Flows*)

The Committee received a request about how an entity presents, in its statement of cash flows, the cash flows related to variation margin call payments made on contracts to purchase or sell commodities at a predetermined price and at a specified time in the future.

Fact pattern

The request describes a contract to purchase or sell commodities at a predetermined price and at a specified time in the future. An entity may enter into such a contract for different purposes and applies the relevant requirements in IFRS Accounting Standards accordingly. For example, the entity may use such a contract:

a. to receive commodities in accordance with its expected usage requirements.

b. to hedge against fluctuations in the prices of commodities.

c. for trading purposes.

Such a contract typically has a maturity of up to three years, can be settled physically or net in cash and is both:

a. *centrally cleared*—after a new contract is entered into, for the purpose of settlement via a central counterparty, the contract is novated by each counterparty to the central counterparty.

b. *'collateralised-to-market'*—during the life of the contract, the counterparties make or receive daily payments based on the fluctuations of the fair value of the contract (variation margin call payments). These variation margin call payments represent a transfer of cash collateral (hence the contract is 'collateralised to market'), rather than a partial settlement of the contract (as in 'settled-to-market' contracts).

The request asked how an entity presents, in its statement of cash flows, the cash flows related to variation margin call payments made on such a contract.

Conclusion

Evidence gathered by the Committee ~~[to date]~~ did not indicate that the matter described in the request is widespread. On the basis of that evidence, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee ~~[~~decided~~]~~ not to add a standard-setting project to the work plan.