IFRIC® *Update*

From the IFRS® Interpretations Committee

March 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 **5-6 March 2019**, and discussed:

Contact us

IFRS Interpretations Committee
The Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
Email: ifric@ifrs.org
Website: **www.ifrs.org**

Next IFRS Interpretations Committee meeting

The next scheduled meeting is on:

30 April 2019

Meeting dates, tentative agendas and additional details about the next meeting will be posted to the IFRS **website** before the meeting. Further information about the activities of the IFRS Interpretations Committee and instructions for submitting requests to it can be found **here**.

Archive of IFRIC *Update*

For archived copies of past issues of IFRIC *Update* **click here**.

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 May 2019. 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 May 2019; agenda papers analysing comments received will include analysis only of comments received by that date.

Holdings of Cryptocurrencies—Agenda Paper 4

The Committee discussed how IFRS Standards apply to holdings of cryptocurrencies.

The Committee noted that a range of cryptoassets exist. For the purposes of its discussion, the Committee considered a subset of cryptoassets—cryptocurrencies—with the following characteristics:

a. A cryptocurrency is a digital or virtual currency that is recorded on a distributed ledger and uses cryptography for security.
b. A cryptocurrency is not issued by a jurisdictional authority or other party.
c. A holding of a cryptocurrency does not give rise to a contract between the holder and another party.

Nature of a cryptocurrency

Paragraph 8 of IAS 38 *Intangible Assets* defines an intangible asset as 'an identifiable non-monetary asset without physical substance'.

Paragraph 12 of IAS 38 states that an asset is identifiable if it is separable or arises from contractual or other legal rights. An asset is separable if it 'is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability'.

Paragraph 16 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* states that 'the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency'.

The Committee observed that a holding of cryptocurrency meets the definition of an intangible asset in IAS 38 on the grounds that (a) it is capable of being separated from the holder and sold or transferred individually; and (b) it does not give the holder a right to receive a fixed or determinable number of units of currency.

Which IFRS Standard applies to holdings of cryptocurrencies?

The Committee concluded that IAS 2 *Inventories* applies to cryptocurrencies when they are held for sale in the ordinary course of business. If IAS 2 is not applicable, an entity applies IAS 38 to holdings of cryptocurrencies. The Committee considered the following in reaching its conclusion.

Intangible Asset

IAS 38 applies in accounting for all intangible assets except:

a. those that are within the scope of another Standard;
b. financial assets, as defined in IAS 32 *Financial Instruments: Presentation*;
c. the recognition and measurement of exploration and evaluation assets; and
d. expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

Accordingly, the Committee considered whether a holding of cryptocurrency meets the definition of a financial asset in IAS 32 or is within the scope of another Standard.

Financial asset

Paragraph 11 of IAS 32 defines a financial asset. In summary, a financial asset is any asset that is: (a) cash; (b) an equity instrument of another entity; (c) a contractual right to receive cash or another financial asset from another entity; (d) a contractual right to exchange financial assets or financial liabilities with another entity under particular conditions; or (e) a particular contract that will or may be settled in the entity's own equity instruments.

The Committee concluded that a holding of cryptocurrency is not a financial asset. This is because a cryptocurrency is not cash (see below). Nor is it an equity instrument of another entity. It does not give rise to a contractual right for the holder and it is not a contract that will or may be settled in the holder's own equity instruments.

Cash

Paragraph AG3 of IAS 32 states that 'currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.'

The Committee observed that the description of cash in paragraph AG3 of IAS 32 implies that cash is expected to be used as a medium of exchange (ie used in exchange for goods or services) and as the monetary unit in pricing goods or services to such an extent that it would be the basis on which all transactions are measured and recognised in financial statements.

Some cryptocurrencies can be used in exchange for particular good or services. However, the Committee noted that it is not aware of any cryptocurrency that is used as a medium of exchange and as the monetary unit in pricing goods or services to such an extent that it would be the basis on which all transactions are measured and recognised in financial statements. Consequently, the Committee concluded that a holding of cryptocurrency is not cash because cryptocurrencies do not currently have the characteristics of cash.

Inventory

IAS 2 applies to inventories of intangible assets. Paragraph 6 of that Standard 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.

The Committee observed that an entity may hold cryptocurrencies for sale in the ordinary course of business. In that circumstance, a holding of cryptocurrency is inventory for the entity and, accordingly, IAS 2 applies to that holding.

The Committee also observed that an entity may act as a broker-trader of cryptocurrencies. In that circumstance, the entity considers the requirements in paragraph 3(b) of IAS 2 for commodity broker-traders who measure their inventories at fair value less costs to sell. Paragraph 5 of IAS 2 states that broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin.

Disclosure

An entity applies the disclosure requirements in the IFRS Standard applicable to its holdings of cryptocurrencies. Accordingly, an entity applies the disclosure requirements in (a) paragraphs 36–39 of IAS 2 to cryptocurrencies held for sale in the ordinary course of business, and (b) paragraphs 118-128 of IAS 38 to holdings of cryptocurrencies to which it applies IAS 38. If an entity measures holdings of cryptocurrencies at fair value, paragraphs 91–99 of IFRS 13 *Fair Value Measurement* specify applicable disclosure requirements.

The Committee noted that, applying paragraph 122 of IAS 1 *Presentation of Financial Statements*, an entity would disclose any judgements that its management has made regarding its accounting for holdings of cryptocurrencies if those are part of the judgements that had the most significant effect on the amounts recognised in the financial statements.

The Committee also noted that paragraph 21 of IAS 10 *Events after the Reporting Period* requires an entity to disclose any material non-adjusting events, including information about the nature of the event and an estimate of its financial effect (or a statement that such an estimate cannot be made). For example, an entity holding cryptocurrencies would consider whether changes in the fair value of those holdings after the reporting period are of such significance that non-disclosure could influence the economic decisions that users of financial statements make on the basis of the financial statements.

Costs to Fulfil a Contract (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 2

The Committee received a request about the recognition of costs incurred to fulfil a contract as an entity satisfies a performance obligation in the contract over time. In the fact pattern described in the request, the entity (a) transfers control of a good over time (ie one (or more) of the criteria in paragraph 35 of IFRS 15 is met) and, therefore, satisfies a performance obligation and recognises revenue over time; and (b) measures progress towards complete satisfaction of the performance obligation using an output method applying paragraphs 39-43 of IFRS 15. The entity incurs costs in constructing the good. At the reporting date, the costs incurred relate to construction work performed on the good that is transferring to the customer as the good is being constructed.

In considering the request, the Committee first noted the principles and requirements in IFRS 15 relating to the measurement of progress towards complete satisfaction of a performance obligation satisfied over time. Paragraph 39 states that 'the objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer.' The Committee also observed that when evaluating whether to apply an output method to measure progress, paragraph B15 requires an entity to 'consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation.'

In considering the recognition of costs, the Committee noted that paragraph 98(c) of IFRS 15 requires an entity to recognise as expenses when incurred costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in a contract—ie costs that relate to past performance.

The Committee observed that the costs of construction described in the request are costs that relate to the partially satisfied performance obligation in the contract—ie they are costs that relate to the entity's past performance. Those costs do not meet the criteria in paragraph 95 of IFRS 15 to be recognised as an asset.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine how to recognise costs incurred in fulfilling a contract in the fact pattern described in the request. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Subsurface Rights (IFRS 16 *Leases*)—Agenda Paper 5

The Committee received a request about a particular contract for subsurface rights. In the contract described in the request, a pipeline operator (customer) obtains the right to place an oil pipeline in underground space for 20 years in exchange for consideration. The contract specifies the exact location and dimensions (path, width and depth) of the underground space within which the pipeline will be placed. The land owner retains the right to use the surface of the land above the pipeline, but it has no right to access or otherwise change the use of the specified underground space throughout the 20-year period of use. The customer has the right to perform inspection, repairs and maintenance work (including replacing damaged sections of the pipeline when necessary).

The request asked whether IFRS 16, IAS 38 *Intangible Assets* or another Standard applies in accounting for the contract.

Which IFRS Standard does an entity consider first?

Paragraph 3 of IFRS 16 requires an entity to apply IFRS 16 to all leases, with limited exceptions. Paragraph 9 of IFRS 16 states: 'At inception of a contract, an entity shall assess whether the contract is, or contains, a lease.'

The Committee observed that, in the contract described in the request, none of the exceptions in paragraphs 3 and 4 of IFRS 16 apply—in particular, the Committee noted that the underground space is tangible. Accordingly, if the contract contains a lease, IFRS 16 applies to that lease. If the contract does not contain a lease, the entity would then consider which other IFRS Standard applies.

The Committee therefore concluded that the entity first considers whether the contract contains a lease as defined in IFRS 16.

The definition of a lease

Paragraph 9 of IFRS 16 states that 'a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.' Applying paragraph B9 of IFRS 16, to meet the definition of a lease the customer must have both:

(a) the right to obtain substantially all the economic benefits from use of an identified asset throughout the period of use; and
(b) the right to direct the use of the identified asset throughout the period of use.

Identified asset

Paragraphs B13–B20 of IFRS 16 provide application guidance on an identified asset. Paragraph B20 states that 'a capacity portion of an asset is an identified asset if it is physically distinct.' But 'a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use' (paragraph B14).

The Committee observed that, in the contract described in the request, the specified underground space is physically distinct from the remainder of the land. The contract's specifications include the path, width and depth of the pipeline, thereby defining a physically distinct underground space. The space being underground does not in itself affect whether it is an identified asset—the specified underground space is physically distinct in the same way that a specified area of space on the land's surface would be physically distinct.

The land owner does not have the right to substitute the underground space throughout the period of use. Consequently, the Committee concluded that the specified underground space is an identified asset as described in paragraphs B13–B20.

Right to obtain substantially all the economic benefits from use

Paragraphs B21–B23 of IFRS 16 provide application guidance on the right to obtain substantially all the economic benefits from use of an identified asset throughout the period of use. Paragraph B21 specifies that a customer can have that right, for example, by having exclusive use of the identified asset throughout the period of use.

The Committee observed that, in the contract described in the request, the customer has the right to obtain substantially all the economic benefits from use of the specified underground space throughout the 20-year period of use. The customer has exclusive use of the specified underground space throughout that period of use.

Right to direct the use

Paragraphs B24-B30 of IFRS 16 provide application guidance on the right to direct the use of an identified asset throughout the period of use. Paragraph B24 specifies that a customer has that right if either:
(a) the customer has the right to direct how and for what purpose the asset is used throughout the period of use; or
(b) the relevant decisions about how and for what purpose the asset is used are predetermined and: (i) the customer has the right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions; or (ii) the customer designed the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

The Committee observed that, in the contract described in the request, the customer has the right to direct the use of the specified underground space throughout the 20-year period of use because the conditions in paragraph B24(b)(i) exist. How and for what purpose the specified underground space will be used (ie to locate the pipeline with specified dimensions through which oil will be transported) is predetermined in the contract. The customer has the right to operate the specified underground space by having the right to perform inspection, repairs and maintenance work. The customer makes all the decisions about the use of the specified underground space that can be made during the 20-year period of use.

Consequently, the Committee concluded that the contract described in the request contains a lease as defined in IFRS 16. The customer applies IFRS 16 in accounting for that lease.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine its accounting for the contract described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Effect of a Potential Discount on Plan Classification (IAS 19 *Employee Benefits*)—Agenda Paper 6

The Committee received a request about the classification of a post-employment benefit plan applying IAS 19. In the fact pattern described in the request, an entity sponsors a post-employment benefit plan (the plan) that is administered by a third party. The relevant terms and conditions of the plan are as follows:

a. the entity has an obligation to pay fixed annual contributions to the plan. The entity has determined that it will have no legal or constructive obligation to pay further contributions if the plan does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

b. the entity is entitled to a potential discount on its annual contributions. The discount arises if the ratio of plan assets to plan liabilities exceeds a set level. Thus, any discount might be affected by actuarial assumptions and the return on plan assets.

The request asked whether the existence of the potential discount would result in a defined benefit plan classification applying IAS 19.

Paragraph 8 of IAS 19 defines defined contribution plans as 'post-employment benefit plans under which an entity pays fixed contributions into a separate entity (fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.' Defined benefit plans are 'post-employment benefit plans other than defined contribution plans.'

Paragraphs 27–30 of IAS 19 specify requirements relating to the classification of post-employment benefit plans as either defined contribution plans or defined benefit plans.

The Committee observed that the definition of defined contribution plans requires that an entity will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. To meet the definition of a defined contribution plan, the entity must therefore (a) have an obligation to pay fixed contributions; and (b) not be obliged to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current or prior periods. For example, there should be no possibility that future contributions could be set to cover shortfalls in funding employee benefits relating to employee service in the current and prior periods.

The Committee also observed that paragraphs 28 and 30 of IAS 19 specify that, under defined contribution plans, actuarial risk and investment risk fall in substance on the employee whereas, under defined benefit plans, those risks fall in substance on the entity. Paragraphs 28 and 30 describe (a) actuarial risk as the risk that benefits will cost the entity more than expected or will be less than expected for the employee; and (b) investment risk as the risk that assets invested will be insufficient to meet expected benefits. Paragraph 28 of IAS 19 states that 'under defined contribution plans the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund.' Paragraph BC29 of IAS 19 explains that the definition of defined contribution plans focuses on the downside risk that the cost to the entity may increase; the definition does not exclude the upside potential that the cost to the entity may be less than expected.

Consequently, the Committee concluded that, in the fact pattern described in the request, the existence of the potential discount would not in itself result in classifying the plan as a defined benefit plan applying IAS 19.

The Committee noted that, applying paragraph 122 of IAS 1 *Presentation of Financial Statements*, an entity would disclose any judgements that its management has made regarding the classification of post-employment benefit plans if those are part of the judgements that had the most significant effect on the amounts recognised in the financial statements.

The Committee concluded that the requirements in IAS 19 provide an adequate basis for an entity to determine the classification of a post-employment benefit plan as a defined contribution plan or a defined benefit plan. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Committee's agenda decisions

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

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).

Application of the Highly Probable Requirement when a Specific Derivative is Designated as a Hedging Instrument (IFRS 9 *Financial Instruments* and IAS 39 *Financial instruments: Recognition and Measurement*)—Agenda Paper 10

The Committee received a request about the requirement in IFRS 9 and IAS 39 that a forecast transaction must be 'highly probable' to qualify as a hedged item in a cash flow hedge relationship. The request asked how an entity applies that requirement when the notional amount of the derivative designated as a hedging instrument (load following swap) varies depending on the outcome of the hedged item (forecast energy sales).

The responses to outreach performed on the request and those received in comment letters confirmed that the financial instrument described in the request is not common. The comment letters also confirmed the views expressed by some Committee members that the request relates to the broader matter of how uncertainty over the timing and magnitude of a forecast transaction affects the highly probable assessment applying IFRS 9 and IAS 39.

The Committee observed that, in a cash flow hedge, a forecast transaction can be a hedged item if, and only if, it is highly probable (paragraphs 6.3.1 and 6.3.3 of IFRS 9 and paragraphs 86(b) and 88(c) of IAS 39). When assessing whether a forecast transaction (in the request, the forecast energy sales) is highly probable, an entity considers uncertainty over both the timing and magnitude of the forecast transaction (paragraphs F.3.7 and F.3.11 of the Implementation Guidance accompanying IAS 39).

The Committee also observed that, for hedge accounting purposes, the entity must document the forecast energy sales with sufficient specificity in terms of timing and magnitude so that when such transactions occur the entity can identify whether the transaction is the hedged transaction. Consequently, the forecast energy sales cannot be specified solely as a percentage of sales during a period because that would lack the required specificity (paragraphs F.3.10 and F.3.11 of the Implementation Guidance accompanying IAS 39).

In addition, the Committee observed that the terms of the hedging instrument (in the request, the load following swap) do not affect the highly probable assessment because the highly probable requirement is applicable to the hedged item.

The Committee noted that the highly probable requirement in IFRS 9 is not new; IAS 39 includes the same requirement. The Board decided not to carry forward any of the hedge accounting related Implementation Guidance that accompanied IAS 39; nonetheless paragraph BC6.95 of IFRS 9 explains that not carrying forward the Implementation Guidance did not mean that the Board had rejected that guidance.

The Committee concluded that the requirements in IFRS 9 and IAS 39 provide an adequate basis for an entity to determine whether a forecast transaction is highly probable. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Physical Settlement of Contracts to Buy or Sell a Non-financial Item (IFRS 9 *Financial Instruments*)—Agenda Paper 11

The Committee received a request about how an entity applies IFRS 9 to particular contracts to buy or sell a non-financial item in the future at a fixed price. The request describes two fact patterns in which an entity accounts for such contracts as derivatives at fair value through profit or loss (FVPL) but nonetheless physically settles the contracts by either delivering or taking delivery of the underlying non-financial item.

IFRS 9 must be applied to 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 those contracts were financial instruments, with one exception. That exception applies to 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 ('own use scope exception' in paragraph 2.4 of IFRS 9).

In the fact patterns described in the request, the entity concludes that the contracts are within the scope of IFRS 9 because they do not meet the own use scope exception. Consequently, the entity accounts for the contracts as derivatives measured at FVPL. The entity does not designate the contracts as part of a hedging relationship for accounting purposes.

At the settlement date, the entity physically settles the contracts by either delivering or taking delivery of the non-financial item. In accounting for that settlement, the request explains that the entity records the cash paid (in the case of the purchase contract) or received (in the case of the sale contract) and derecognises the derivative.

In addition, the entity:

a. recognises inventory for the non-financial item at the amount of the cash paid plus the fair value of the derivative on the settlement date (in the case of the purchase contract); or
b. recognises revenue for the sale of the non-financial item at the amount of the cash received plus the fair value of the derivative on the settlement date (in the case of the sale contract). The request assumes the entity has an accounting policy of recognising revenue on a gross basis for such contracts.

The request asked whether, in accounting for the physical settlement of these contracts, the entity is permitted or required to make an additional journal entry that would:

a. reverse the accumulated gain or loss previously recognised in profit or loss on the derivative (even though the fair value of the derivative is unchanged); and
b. recognise a corresponding adjustment to either revenue (in the case of the sale contract) or inventory (in the case of the purchase contract).

The Committee observed that, in the fact patterns described in the request, the contracts are settled by the receipt (or delivery) of a non-financial item in exchange for both cash and the settlement of the derivative asset or liability. The Committee also observed that the accounting for contracts that do not meet the own use scope exception in IFRS 9 (and are accounted for as a derivative) is different from the accounting for contracts that meet that exception (and are not accounted for as a derivative). Similarly, the accounting for contracts designated in a hedging relationship for accounting purposes is different from the accounting for contracts that are not designated in such relationships. Those differences in accounting reflect differences in the respective requirements. IFRS 9 neither permits nor requires an entity to reassess or change its accounting for a derivative contract because that contract is ultimately physically settled.

The additional journal entry described in the request would effectively negate the requirement in IFRS 9 to account for the contract as a derivative because it would reverse the accumulated fair value gain or loss on the derivative without any basis to do so. The additional journal entry would also result in the recognition of income or expenses on the derivative that do not exist.

Consequently, the Committee concluded that IFRS 9 neither permits nor requires an entity to make the additional journal entry described in the request. However, the Committee observed that an entity is required to present gains and losses on the derivative, and disclose information about those amounts, applying applicable IFRS Standards, such as IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures*. In determining what line items to present in profit or loss, the requirements in IAS 1 (including those related to aggregation) are applicable. IAS 1 does not specify requirements for the presentation of amounts related to the remeasurement of derivatives. However paragraph 20(a)(i) of IFRS 7 specifies disclosure requirements for net gains or net losses on financial assets or financial liabilities that are mandatorily measured at FVPL applying IFRS 9. For these purposes, in the fact patterns described in the request, there is no gain or loss on the derivative caused by settlement.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to conclude on whether it is permitted or required to make the additional journal entry described in the request. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Credit Enhancement in the Measurement of Expected Credit Losses (IFRS 9 *Financial Instruments*)—Agenda Paper 12

The Committee received a request about the effect of a credit enhancement on the measurement of expected credit losses when applying the impairment requirements in IFRS 9. The request asked whether the cash flows expected from a financial guarantee contract or any other credit enhancement can be included in the measurement of expected credit losses if the credit enhancement is required to be recognised separately applying IFRS Standards.

For the purposes of measuring expected credit losses, paragraph B5.5.55 of IFRS 9 requires the estimate of expected cash shortfalls to 'reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity.'

Accordingly, the Committee observed that the cash flows expected from a credit enhancement are included in the measurement of expected credit losses if the credit enhancement is both:

a. part of the contractual terms; and
b. not recognised separately by the entity.

The Committee concluded that, if a credit enhancement is required to be recognised separately by IFRS Standards, an entity cannot include the cash flows expected from it in the measurement of expected credit losses. An entity applies the applicable IFRS Standard to determine whether it is required to recognise a credit enhancement separately. Paragraph B5.5.55 of IFRS 9 does not provide an exemption from applying the separate recognition requirements in IFRS 9 or other IFRS Standards.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to determine whether to include the cash flows expected from a credit enhancement in the measurement of expected credit losses in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Related discussion at the ITG

In December 2015, the Transition Resource Group for Impairment of Financial Instruments (ITG) discussed a related but separate matter about the inclusion of cash flows from collateral and other credit enhancements in the measurement of expected credit losses. Specifically, the ITG discussed what is meant by 'part of the contractual terms' in paragraph B5.5.55 of IFRS 9.

Curing of a Credit-impaired Financial Asset (IFRS 9 *Financial Instruments*)—Agenda Paper 13

The Committee received a request about how an entity presents amounts recognised in the statement of profit or loss when a credit-impaired financial asset is subsequently cured (ie paid in full or no longer credit-impaired).

When a financial asset becomes credit-impaired, paragraph 5.4.1(b) of IFRS 9 requires an entity to calculate interest revenue by applying the 'effective interest rate to the amortised cost of the financial asset'. This results in a difference between (a) the interest that would be calculated by applying the effective interest rate to the gross carrying amount of the credit-impaired financial asset; and (b) the interest revenue recognised for that asset. The request asked whether, following the curing of the financial asset, an entity can present this difference as interest revenue or, instead, is required to present it as a reversal of impairment losses.

Appendix A to IFRS 9 defines a credit loss as 'the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate…'. Appendix A also defines the gross carrying amount as 'the amortised cost of a financial asset, before adjusting for any loss allowance.' The Committee noted that, based on the definitions in Appendix A to IFRS 9, the gross carrying amount, amortised cost and loss allowance are discounted amounts, and changes in these amounts during a reporting period include the effect of the unwinding of the discount.

Paragraph 5.5.8 of IFRS 9 requires an entity to 'recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.'

The Committee observed that, applying paragraph 5.5.8 of IFRS 9, an entity recognises in profit or loss as a reversal of expected credit losses the adjustment required to bring the loss allowance to the amount that is required to be recognised in accordance with IFRS 9 (zero if the asset is paid in full). The amount of this adjustment includes the effect of the unwinding of the discount on the loss allowance during the period that the financial asset was credit-impaired, which means the reversal of impairment losses may exceed the impairment losses recognised in profit or loss over the life of the asset.

The Committee also observed that paragraph 5.4.1 specifies how an entity calculates interest revenue using the effective interest method. Applying paragraph 5.4.1(b), an entity calculates interest revenue on a credit-impaired financial asset by applying the effective interest rate to the amortised cost of the financial asset, and thus interest revenue on such a financial asset does not include the difference described in the request.

Accordingly, the Committee concluded that, in the statement of profit or loss, an entity is required to present the difference described in the request as a reversal of impairment losses following the curing of a credit-impaired financial asset.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to recognise and present the reversal of expected credit losses following the curing of a credit-impaired financial asset in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda Paper 13: Educational material

The staff will develop educational material relating to the Committee's conclusion in the agenda decision.

Sale of Output by a Joint Operator (IFRS 11 *Joint Arrangements*)—Agenda Paper 8

The Committee received a request about the recognition of revenue by a joint operator for output arising from a joint operation (as defined in IFRS 11) when the output it receives in a reporting period is different from the output to which it is entitled. In the fact pattern described in the request, the joint operator has the right to receive a fixed proportion of the output arising from the joint operation and is obliged to pay for a fixed proportion of the production costs incurred. For operational reasons, the output received by the joint operator and transferred to its customers in a particular reporting period is different from the output to which it is entitled. That difference will be settled through future deliveries of output arising from the joint operation—it cannot be settled in cash. Applying IFRS 15 *Revenue from Contracts with Customers*, the joint operator recognises revenue as a principal for the transfer of all the output to its customers.

The request asked whether, in the fact pattern described, the joint operator recognises revenue to depict the transfer of output to its customers in the reporting period or, instead, to depict its entitlement to a fixed proportion of the output produced from the joint operation's activities in that period.

In relation to its interest in a joint operation, paragraph 20(c) of IFRS 11 requires a joint operator to recognise 'its revenue from the sale of its share of the output arising from the joint operation'. Accordingly, the revenue recognised by a joint operator depicts the output it has received from the joint operation and sold, rather than for example the production of output. The joint operator accounts for the revenues relating to its interest in the joint operation applying the IFRS Standards applicable to the particular revenues (paragraph 21 of IFRS 11).

The Committee concluded that, in the fact pattern described in the request, the joint operator recognises revenue that depicts only the transfer of output to its customers in each reporting period, ie revenue recognised applying IFRS 15. This means, for example, the joint operator does not recognise revenue for the output to which it is entitled but which it has not received from the joint operation and sold.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a joint operator to determine its revenue from the sale of its share of output arising from a joint operation as described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Liabilities in relation to a Joint Operator's Interest in a Joint Operation (IFRS 11 *Joint Arrangements*)—Agenda Paper 9

The Committee received a request about the recognition of liabilities by a joint operator in relation to its interest in a joint operation (as defined in IFRS 11). In the fact pattern described in the request, the joint operation is not structured through a separate vehicle. One of the joint operators, as the sole signatory, enters into a lease contract with a third-party lessor for an item of property, plant and equipment that will be operated jointly as part of the joint operation's activities. The joint operator that signed the lease contract (hereafter, the operator) has the right to recover a share of the lease costs from the other joint operators in accordance with the contractual arrangement to the joint operation.

The request asked about the recognition of liabilities by the operator.

In relation to its interest in a joint operation, paragraph 20(b) of IFRS 11 requires a joint operator to recognise 'its liabilities, including its share of any liabilities incurred jointly'. Accordingly, a joint operator identifies and recognises both (a) liabilities it incurs in relation to its interest in the joint operation; and (b) its share of any liabilities incurred jointly with other parties to the joint arrangement.

Identifying the liabilities that a joint operator incurs and those incurred jointly requires an assessment of the terms and conditions in all contractual agreements that relate to the joint operation, including consideration of the laws pertaining to those agreements.

The Committee observed that the liabilities a joint operator recognises include those for which it has primary responsibility.

The Committee highlighted the importance of disclosing information about joint operations that is sufficient for a user of financial statements to understand the activities of the joint operation and a joint operator's interest in that operation. The Committee noted that, applying paragraph 20(a) of IFRS 12 *Disclosure of Interests in Other Entities*, a joint operator is required to disclose information that enables users of its financial statements to evaluate the nature, extent and financial effects of its interests in a joint operation, including the nature and effects of its contractual relationship with the other investors with joint control of that joint operation.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for the operator to identify and recognise its liabilities in relation to its interest in a joint operation. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda paper 9: Report to the Board

Respondents to the tentative agenda decision suggested that the Board consider more broadly the accounting for this type of joint operation as part of its Post-Implementation Review (PIR) of IFRS 11.

Over Time Transfer of Constructed Good (IAS 23 *Borrowing Costs*)— Agenda Paper 3

The Committee received a request about the capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development (building).

In the fact pattern described in the request:

a. a real estate developer (entity) constructs the building and sells the individual units in the building to customers.
b. the entity borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing.
c. before construction begins, the entity signs contracts with customers for the sale of some of the units in the building (sold units).
d. the entity intends to enter into contracts with customers for the remaining part-constructed units (unsold units) as soon as it finds suitable customers.
e. the terms of, and relevant facts and circumstances relating to, the entity's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers*, the entity transfers control of each unit over time and, therefore, recognises revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

The request asked whether the entity has a qualifying asset as defined in IAS 23 and, therefore, capitalises any directly attributable borrowing costs.

Applying paragraph 8 of IAS 23, an entity capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 5 of IAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

Accordingly, the entity assesses whether, in the fact pattern described in the request, it recognises an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Depending on the particular facts and circumstances, the entity might recognise a receivable, a contract asset and/or inventory.

The Committee concluded that, in the fact pattern described in the request:

a. a receivable that the entity recognises is not a qualifying asset. Paragraph 7 of IAS 23 specifies that financial assets are not qualifying assets.
b. a contract asset that the entity recognises is not a qualifying asset. The contract asset (as defined in Appendix A to IFRS 15) would represent the entity's right to consideration that is conditioned on something other than the passage of time in exchange for transferring control of a unit. The intended use of the contract asset—to collect cash or another financial asset—is not a use for which it necessarily takes a substantial period of time to get ready.
c. inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the request, this asset is ready for its intended sale in its current condition—ie the entity intends to sell the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer.

The Committee concluded that the principles and requirements in IAS 23 provide an adequate basis for an entity to determine whether to capitalise borrowing costs in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda Paper 3: Educational material

The staff will develop educational material relating to the Committee's conclusion in the agenda decision.

Customer's Right to Receive Access to the Supplier's Software Hosted on the Cloud (IAS 38 *Intangible Assets*)—Agenda Paper 7

The Committee received a request about how a customer accounts for a 'Software as a Service' cloud computing arrangement in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier's application software for a specified term. The supplier's software runs on cloud infrastructure managed and controlled by the supplier. The customer accesses the software on an as needed basis over the internet or via a dedicated line. The contract does not convey to the customer any rights over tangible assets.

Does the customer receive a software asset at the contract commencement date or a service over the contract term?

The Committee noted that a customer receives a software asset at the contract commencement date if either (a) the contract contains a software lease, or (b) the customer otherwise obtains control of software at the contract commencement date.

A software lease

IFRS 16 *Leases* defines a lease as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. Paragraphs 9 and B9 of IFRS 16 explain that a contract conveys the right to use an asset if, throughout the period of use, the customer has both:

a. the right to obtain substantially all the economic benefits from use of the asset (an identified asset); and
b. the right to direct the use of that asset.

Paragraphs B9–B31 of IFRS 16 provide application guidance on the definition of a lease. Among other requirements, that application guidance specifies that a customer generally has the right to direct the use of an asset by having decision-making rights to change how and for what purpose the asset is used throughout the period of use. Accordingly, in a contract that contains a lease the supplier has given up those decision-making rights and transferred them to the customer at the lease commencement date.

The Committee observed that a right to receive future access to the supplier's software running on the supplier's cloud infrastructure does not in itself give the customer any decision-making rights about how and for what purpose the software is used—the supplier would have those rights by, for example, deciding how and when to update or reconfigure the software, or deciding on which hardware (or infrastructure) the software will run. Accordingly, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the contract does not contain a software lease.

A software intangible asset

IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 specifies that an entity controls an intangible asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The Committee observed that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date. A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Consequently, the Committee concluded that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract. The customer receives the service—the access to the software—over the contract term. If the customer pays the supplier before it receives the service, that prepayment gives the customer a right to future service and is an asset for the customer.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for fees paid or payable to receive access to the supplier's application software in Software as a

Service arrangements. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda paper 7: Report to the Board

Respondents to the tentative agenda decision highlighted shortcomings in the requirements of IAS 38 in their application to intangible asset arrangements linked to digitalisation.

Other matters

Committee Work in Progress—Agenda Paper 14

The Committee received a report on one new request for consideration and one ongoing matter. The Committee will discuss each of these at a future meeting.

Go to top