IFRIC Update March 2020

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 3 March 2020, and discussed:

Committee's tentative agenda decisions

- Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 2
- Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)—Agenda Paper 3

Committee's agenda decisions

- Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)—Agenda Paper 4A
- Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29)—Agenda Paper 4B
- Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary (IAS 21 and IAS 29)—Agenda Paper 4C
- Training Costs to Fulfil a Contract (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 5

Other matters

- Work in Progress—Agenda Paper 6

Related information

Next scheduled IFRS Interpretations Committee meeting:

- 29 April 2020

Interpretations Committee open items

For further information about IFRS Interpretations Committee activities including how to receive past 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 13 May 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 a good reason, for example, commercial confidence. The Committee will consider all comments received in writing by 13 May 2020; agenda papers analysing comments received will include analysis only of comments received by that date.

Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 2

The Committee received a request about a sale and leaseback transaction with variable payments. In the transaction described in the request:

a. an entity (seller-lessee) enters into a sale and leaseback transaction whereby it transfers an item of property, plant and equipment (PPE) to another entity (buyer-lessor) and leases the asset back for five years.
b. the transfer of the PPE satisfies the requirements in IFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale of the PPE. The amount paid by the buyer-lessor to the seller-lessee in exchange for the PPE equals the PPE's fair value at the date of the transaction.
c. payments for the lease (which are at market rates) include variable payments, calculated as a percentage of the seller-lessee's revenue generated using the PPE during the five-year lease term. The seller-lessee has determined that the variable payments are not in-substance fixed payments as described in IFRS 16.

The request asked how, in the transaction described, 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 observed that the requirements applicable to the transaction described in the request are in paragraph 100 of IFRS 16. Paragraph 100 states that 'if the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset: (a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor…'.

Consequently, to measure the right-of-use asset arising from the leaseback, the seller-lessee determines the proportion of the PPE transferred to the buyer-lessor that relates to the right of use retained—it does so by comparing, at the date of the transaction, the right of use it retains via the leaseback to the rights comprising the entire PPE. IFRS 16 does not prescribe a method for determining that proportion. In the transaction described in the request, the seller-lessee could determine the proportion by comparing, for example, (a) the present value of expected payments for the lease (including those that are variable), to (b) the fair value of the PPE at the date of the transaction.

The gain or loss the seller-lessee recognises at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the PPE's previous carrying amount), the amount of the gain or loss recognised relates only to the rights transferred to the buyer-lessor. Applying paragraph 53(i) of IFRS 16, the seller-lessee discloses gains or losses arising from sale and leaseback transactions.

The seller-lessee also recognises a lease liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the lease liability is a consequence of how the right-of-use asset is measured—and the gain or loss on the sale and leaseback transaction determined—applying paragraph 100(a) of IFRS 16.

Illustrative example

Seller-lessee enters into a sale and leaseback transaction whereby it transfers an asset (PPE) to Buyer-lessor, and leases that PPE back for five years. The transfer of the PPE satisfies the requirements in IFRS 15 to be accounted for as a sale of the PPE.

The carrying amount of the PPE in Seller-lessee's financial statements at the date of the transaction is CU1,000,000, and the amount paid by Buyer-lessor for the PPE is CU1,800,000 (the fair value of the PPE at that date). All the payments for the lease (which are at market rates) are variable, calculated as a percentage of Seller-lessee's revenue generated using the PPE during the five-year lease term. At the date of the transaction, the present value of the expected payments for the lease is CU450,000. There are no initial direct costs.

Seller-lessee determines that it is appropriate to calculate the proportion of the PPE that relates to the right of use retained using the present value of expected payments for the lease. On this basis, the proportion of the PPE that relates to the right of use retained is 25%, calculated as CU450,000 (present value of expected payments for the lease) ÷ CU1,800,000 (fair value of the PPE). Consequently, the proportion of the PPE that relates to the rights transferred to Buyer-lessor is 75%, calculated as (CU1,800,000 - CU450,000) ÷ CU1,800,000.

Applying paragraph 100(a), Seller-lessee:

a. *measures the right-of-use asset at CU250,000, calculated as CU1,000,000 (previous carrying amount of the PPE) × 25% (proportion of the PPE that relates to the right of use it retains).*
b. *recognises a gain of CU600,000 at the date of the transaction, which is the gain that relates to the rights transferred to Buyer-lessor. This gain is calculated as CU800,000 (total gain on sale of the PPE (CU1,800,000 – CU1,000,000)) × 75% (proportion of the PPE that relates to rights transferred to Buyer-lessor).*

At the date of the transaction, Seller-lessee accounts for the transaction as follows:

Dr. Cash	*CU1,800,000*	
Dr. Right-of-use asset	*CU250,000*	
Cr. PPE		*CU1,000,000*
Cr. Lease liability		*CU450,000*
Cr. Gain on rights transferred		*CU600,000*

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine, at the date of the transaction, the accounting for the sale and leaseback transaction described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Narrow-scope amendment to IFRS 16

The Committee recommended that the Board amend IFRS 16 to specify how the seller-lessee applies IFRS 16's subsequent measurement requirements to the lease liability that arises in the sale and leaseback transaction. The Board will consider the Committee's recommendation at a future meeting.

Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)—Agenda Paper 3

The Committee received a request about how an entity, in its consolidated financial statements, accounts for deferred tax related to its investment in a subsidiary. In the fact pattern described in the request:

a. undistributed profits of the subsidiary give rise to a taxable temporary difference associated with the entity's investment in the subsidiary.
b. the entity has determined that the conditions in paragraph 39 of IAS 12 for applying the exception from recognising a deferred tax liability related to its investment in the subsidiary are not satisfied. This is because the entity expects the subsidiary to distribute its profits (which are available for distribution) in the foreseeable future.
c. the entity and subsidiary operate in a jurisdiction in which:
    i. profits are taxable only when distributed—that is, the income tax rate applicable to undistributed profits is nil (undistributed tax rate).
    ii. a 20% tax rate applies to profit distributions (distributed tax rate). However, profit distributions made by the entity are not taxable to the extent that the subsidiary has already been taxed on that profit—that is, profit distributions are taxed only once.

The request asked whether the entity recognises a deferred tax liability for the taxable temporary difference associated with its investment in the subsidiary.

Paragraph 39 of IAS 12 requires an entity to recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, except to the extent that (a) the parent is able to control the timing of the reversal of the temporary difference; and (b) it is probable that the temporary difference will not reverse in the foreseeable future.

In the fact pattern described in the request, there is a taxable temporary difference associated with the entity's investment in the subsidiary. The entity has also determined that the recognition exception in paragraph 39 of IAS 12 does not apply because it is probable that the temporary difference will reverse in the foreseeable future when the subsidiary distributes its undistributed profits. Accordingly, the Committee concluded that the entity recognises a deferred tax liability for that taxable temporary difference.

Paragraph 51 of IAS 12 requires an entity to reflect—in the measurement of deferred tax assets and deferred tax liabilities—'the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities'.

In the fact pattern described in the request, the entity expects to recover the carrying amount of its investment in the subsidiary through distributions of profits by the subsidiary, which would be taxed at the distributed tax rate. Accordingly, the Committee concluded that, in applying paragraph 51 of IAS 12, the entity uses the distributed tax rate to measure the deferred tax liability related to its investment in the subsidiary.

The Committee observed that, in the fact pattern described in the request, the entity does not apply paragraph 57A of IAS 12—that paragraph applies only in the context of dividends payable by the reporting entity. Further, paragraph 52A of IAS 12 does not apply to the measurement of tax that itself reflects the tax consequences of a distribution of profits.

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.

Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)—Agenda Paper 4A

The Committee received a request about the application of IAS 21 and IAS 29. In the fact pattern described in the request, the entity:

a. has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;
b. has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and
c. translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

Paragraph 43 of IAS 21 requires an entity to restate the results and financial position of a hyperinflationary foreign operation applying IAS 29 before applying the translation method set out in paragraph 42 of IAS 21 (restate/translate approach). The application of the restate/translate approach may result in a change to the entity’s net investment in the hyperinflationary foreign operation. This change would include two effects:

a. a restatement effect resulting from restating the entity’s interest in the equity of the hyperinflationary foreign operation as required by IAS 29; and
b. a translation effect resulting from translating the entity’s interest in the equity of the hyperinflationary foreign operation (excluding the effect of any restatement required by IAS 29) at a closing rate that differs from the previous closing rate.

To illustrate this using a simple example, assume at the beginning of the reporting period that an entity has a 100% interest in a hyperinflationary foreign operation that has a non-monetary asset of 1,000 in local currency (LC), no other assets and no liabilities. Therefore, the foreign operation has net assets (and equity) of LC1,000. The change in the general price index of the hyperinflationary economy during the reporting period is 200%. The entity could, for example, calculate:

a. the restatement effect as (LC1,000 × (1+200%) – LC1,000) × closing exchange rate. This calculation reflects the entity’s interest in the equity of the hyperinflationary foreign operation of LC1,000, restated applying IAS 29, and reported in the entity’s presentation currency; and

b. the translation effect as (LC1,000 × closing exchange rate) – (LC1,000 × opening exchange rate). This calculation reflects the entity's interest in the equity of the hyperinflationary foreign operation of LC1,000 (excluding the effect of the restatement required by IAS 29) multiplied by the difference between the opening and closing exchange rates.

The request asked how the entity presents the restatement and translation effects in its statement of financial position.

Do the restatement and translation effects meet the definition of an exchange difference?

Paragraph 8 of IAS 21 defines an exchange difference as the difference 'resulting from translating a given number of units of one currency into another currency at different exchange rates'. The Committee concluded that, in the fact pattern described in the request, either the translation effect alone meets the definition of an exchange difference, or the combination of the restatement and translation effects meets that definition.

How does an entity present any exchange difference arising from translating a hyperinflationary foreign operation?

The Committee observed that all requirements in IAS 21 that specify the recognition (or presentation) of exchange differences require an entity to recognise (or present) exchange differences in profit or loss or other comprehensive income (OCI). IAS 21 requires the recognition of exchange differences in profit or loss or OCI—with no reference to equity—because exchange differences meet the definition of income or expenses. Accordingly, the Committee concluded that an entity does not recognise exchange differences directly in equity.

Paragraph 7 of IAS 1 *Presentation of Financial Statements* states that components of OCI include 'gains and losses arising from translating the financial statements of a foreign operation'. Paragraph 41 of IAS 21 explains that exchange differences arising from translating the financial statements of a non-hyperinflationary foreign operation are recognised in OCI—and not in profit or loss—because 'the changes in exchange rates have little or no direct effect on the present and future cash flows from operations'. The Committee observed that this explanation is also relevant if the foreign operation's functional currency is hyperinflationary. Accordingly, the Committee concluded that an entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation.

Applying the requirements in IFRS Standards to the restatement and translation effects

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

a. the restatement and translation effects in OCI, if the entity considers that the combination of those two effects meets the definition of an exchange difference in IAS 21; or
b. the translation effect in OCI, if the entity considers that only the translation effect meets the definition of an exchange difference in IAS 21. In this case, consistent with the requirements in paragraph 25 of IAS 29, the entity presents the restatement effect in equity.

In the light of its analysis, the Committee considered whether to add a project on the presentation of exchange differences resulting from the restatement and translation of hyperinflationary foreign operations to its standard-setting agenda. The Committee has not obtained evidence that a project with that scope—undertaken in isolation of other aspects of the accounting for hyperinflationary foreign operations—would result in an improvement in financial reporting that would be sufficient to outweigh the costs. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)—Agenda Paper 4B

The Committee received a request about the application of IAS 21 and IAS 29. In the fact pattern described in the request, the entity:

a. has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;
b. has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and
c. translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

Before the foreign operation becomes hyperinflationary, IAS 21 requires an entity to:

a. present in other comprehensive income (OCI) any exchange differences resulting from translating the results and financial position of that non-hyperinflationary foreign operation; and
b. present in a separate component of equity the cumulative amount of those exchange differences (cumulative pre-hyperinflation exchange differences).

The request asked whether the entity reclassifies within equity the cumulative pre-hyperinflation exchange differences once the foreign operation becomes hyperinflationary—that is, whether the entity transfers the cumulative pre-hyperinflation exchange differences to a component of equity that is not subsequently reclassified to profit or loss.

Paragraph 41 of IAS 21 requires an entity to present the cumulative amount of exchange differences recognised in OCI in a separate component of equity ‘until disposal of the foreign operation’. Further, paragraphs 48 and 48C of IAS 21 require an entity to reclassify the cumulative amount of those exchange differences—or a proportionate share of that cumulative amount—from equity to profit or loss on disposal—or partial disposal—of a foreign operation (except as specified in paragraph 48C).

Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity presents the cumulative amount of the exchange differences as a separate component of equity (to which paragraph 48 or 48C of IAS 21 applies) until disposal or partial disposal of the foreign operation. The entity does not reclassify within equity the cumulative pre-hyperinflation exchange differences once the foreign operation becomes hyperinflationary.

The Committee concluded that the principles and requirements in IAS 21 provide an adequate basis for an entity to determine how to present the cumulative pre-hyperinflation exchange differences once a foreign operation becomes hyperinflationary. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)—Agenda Paper 4C

The Committee received a request about the application of IAS 21 and IAS 29. In the fact pattern described in the request, the entity:

a. has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;
b. has a foreign operation whose functional currency is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and
c. translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

The request asked whether the entity restates comparative amounts presented for the foreign operation in:

a. its annual financial statements for the period in which the foreign operation becomes hyperinflationary; and
b. its interim financial statements in the year after the foreign operation becomes hyperinflationary, if the foreign operation was not hyperinflationary during the comparative interim period.

On the basis of responses to outreach, comment letters received and additional research, the Committee observed little diversity in the application of IAS 21 with respect to the questions in the request—in applying paragraph 42(b) of IAS 21, entities generally do not restate comparative amounts in their interim or annual financial statements in the situations described above. Therefore, the Committee has not obtained evidence that the matter has widespread effect. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Training Costs to Fulfil a Contract (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 5

The Committee received a request about training costs incurred to fulfil a contract with a customer. In the fact pattern described in the request:

a. an entity enters into a contract with a customer that is within the scope of IFRS 15. The contract is for the supply of outsourced services.
b. to be able to provide the services to the customer, the entity incurs costs to train its employees so that they understand the customer's equipment and processes. The training costs are as described in paragraph 15 of IAS 38 *Intangible Assets*—the entity has insufficient control over the expected future economic benefits arising from the training to meet the definition of an intangible asset because employees can leave the entity's employment. Applying IFRS 15, the entity does not identify the training activities as a performance obligation.
c. the contract permits the entity to charge to the customer the costs of training (i) the entity's employees at the beginning of the contract, and (ii) new employees that the entity hires as a result of any expansion of the customer's operations.

The request asked whether the entity recognises the training costs as an asset or an expense when incurred.

Which IFRS Standard applies to the training costs?

Paragraph 95 of IFRS 15 requires an entity to recognise an asset from the costs incurred to fulfil a contract with a customer if the costs are not within the scope of another IFRS Standard, and only if those costs meet all three criteria specified in paragraph 95. Consequently, before assessing the criteria in paragraph 95, the entity first considers whether the training costs incurred to fulfil the contract are within the scope of another IFRS Standard.

Paragraphs 2–7 of IAS 38 describe the scope of that Standard—paragraph 5 explicitly includes expenditure on training within IAS 38's scope, stating that IAS 38 'applies to, among other things, expenditure on advertising, training, start-up, research and development activities'. Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity applies IAS 38 in accounting for the training costs incurred to fulfil the contract with the customer.

Application of IAS 38

Paragraph 69(b) of IAS 38 includes expenditure on training activities as an example of expenditure that is incurred 'to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised'. Consequently, paragraph 69 states that such expenditure on training activities is recognised as an expense when incurred. Paragraph 15 of IAS 38 explains that 'an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset'.

In addition, in explaining the requirements in IFRS 15 regarding costs to fulfil a contract, paragraph BC307 of IFRS 15 states that 'if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under IFRS 15'.

Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity recognises the training costs to fulfil the contract with the customer as an expense when incurred. The Committee noted that the entity's ability to charge to the customer the costs of training does not affect that conclusion.

The Committee concluded that the principles and requirements in IFRS 15 and IAS 38 provide an adequate basis for an entity to determine its accounting for training costs incurred to fulfil a contract with a customer. Consequently, the Committee decided not to add the matter to its standard-setting agenda.

Other matters

Work in Progress—Agenda Paper 6

The Committee received an update on the current status of open matters not discussed at its meeting in March 2020.