IFRIC Update June 2020

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

The Committee met on 16 June 2020, and discussed:

Committee's tentative agenda decisions

- Supply Chain Financing Arrangements—Reverse Factoring—Agenda Paper 2

Committee's agenda decisions

- Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 3
- Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)—Agenda Paper 4
- Player Transfer Payments (IAS 38 *Intangible Assets*)—Agenda Paper 5

Other matters

- Work in Progress—Agenda Paper 6

Related information

Next scheduled IFRS Interpretations Committee meeting:

- 15-16 September 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 matter and tentatively decided not to add the matter to its standard-setting agenda. The Committee will reconsider this tentative decision, including the reasons for not adding the matter to its standard-setting agenda, at a future meeting. The Committee invites comments on the tentative agenda decision. Interested parties may submit comments on the open for comment page by 30 September 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 30 September 2020; agenda papers analysing comments received will include analysis only of comments received by that date.

Supply Chain Financing Arrangements—Reverse Factoring—Agenda Paper 2

The Committee received a request about reverse factoring arrangements. Specifically, the request asked:

a. how an entity presents liabilities to which reverse factoring arrangements relate (ie how it presents liabilities to pay for goods or services received when the related invoices are part of a reverse factoring arrangement); and
b. what information about reverse factoring arrangements an entity is required to disclose in its financial statements.

In a reverse factoring arrangement, a financial institution agrees to pay amounts an entity owes to the entity's suppliers and the entity agrees to pay the financial institution at a date later than suppliers are paid.

Presentation in the statement of financial position

IAS 1 *Presentation of Financial Statements* specifies requirements for the presentation of liabilities in an entity's statement of financial position. Paragraph 54 requires an entity to present 'trade and other payables' separately from other financial liabilities. 'Trade and other payables' are sufficiently different in nature or function from other financial liabilities to warrant separate presentation (paragraph 57 of IAS 1).

Paragraph 11(a) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that 'trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier'. Paragraph 70 of IAS 1 explains that 'some current liabilities, such as trade payables… are part of the working capital used in the entity's normal operating cycle'. The Committee therefore concluded that an entity presents a financial liability as a trade payable only when it:

a. represents a liability to pay for goods or services;
b. is invoiced or formally agreed with the supplier; and
c. is part of the working capital used in the entity's normal operating cycle.

Paragraph 29 of IAS 1 requires an entity to ‘present separately items of a dissimilar nature or function unless they are immaterial’. Paragraph 57 specifies that line items are included in the statement of financial position when the size, nature or function of an item (or aggregation of similar items) is such that separate presentation is relevant to an understanding of the entity’s financial position. Accordingly, the Committee concluded that, applying IAS 1, an entity presents:

a. other payables together with trade payables only when those other payables have a similar nature and function to trade payables—for example, when other payables are part of the working capital used in the entity’s normal operating cycle.
b. liabilities that are part of a reverse factoring arrangement separately when the size, nature or function of those liabilities makes separate presentation relevant to an understanding of the entity’s financial position. In assessing whether to present such liabilities separately (including whether to disaggregate trade and other payables), an entity considers the amounts, nature and timing of those liabilities (paragraphs 55 and 58 of IAS 1).

The Committee observed that an entity assessing whether to present liabilities that are part of a reverse factoring arrangement separately might consider factors including, for example:

a. whether additional security is provided as part of the arrangement that would not be provided without the arrangement.
b. whether the terms of liabilities that are part of the arrangement are substantially different from the terms of the entity’s trade payables that are not part of the arrangement.

Derecognition of a financial liability

An entity assesses whether and when to derecognise a liability that is (or becomes) part of a reverse factoring arrangement applying the derecognition requirements in IFRS 9 *Financial Instruments*.

An entity that derecognises a trade payable to a supplier and recognises a new financial liability to a financial institution applies IAS 1 in determining how to present that new liability in its statement of financial position (see ‘Presentation in the statement of financial position’).

Presentation in the statement of cash flows

Paragraph 6 of IAS 7 *Statement of Cash Flows* defines:

a. operating activities as ‘the principal revenue-producing activities of the entity and other activities that are not investing or financing activities’; and
b. financing activities as ‘activities that result in changes in the size and composition of the contributed equity and borrowings of the entity’.

An entity that has entered into a reverse factoring arrangement determines whether to classify cash flows under the arrangement as cash flows from operating activities or cash flows from financing activities. The Committee observed that an entity's assessment of the nature of the liabilities that are part of the arrangement may help in determining the nature of the related cash flows as arising from operating or financing activities. For example, if the entity considers the related liability to be a trade or other payable that is part of the working capital used in the entity's principal revenue-producing activities, the entity presents cash outflows to settle the liability as arising from operating activities in its statement of cash flows. In contrast, if the entity considers that the related liability is not a trade or other payable because the liability represents borrowings of the entity, the entity presents cash outflows to settle the liability as arising from financing activities in its statement of cash flows.

Investing and financing transactions that do not require the use of cash or cash equivalents are excluded from an entity's statement of cash flows (paragraph 43 of IAS 7). Consequently, if a cash inflow and cash outflow occur for an entity when an invoice is factored as part of a reverse factoring arrangement, the entity presents those cash flows in its statement of cash flows. If no cash flows are involved in a financing transaction of an entity, the entity discloses the transaction elsewhere in the financial statements in a way that provides all the relevant information about the financing activity (paragraph 43 of IAS 7).

Notes to the financial statements

Paragraph 44A of IAS 7 requires an entity to provide 'disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes'. The Committee noted that such disclosure is required for liabilities that are part of a reverse factoring arrangement if the cash flows for those liabilities were, or future cash flows will be, classified as cash flows from financing activities.

IFRS 7 *Financial Instruments: Disclosures* defines liquidity risk as 'the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset'. The Committee observed that reverse factoring arrangements often give rise to liquidity risk because:

a. the entity has concentrated a portion of its liabilities with one financial institution rather than a diverse group of suppliers. The entity may also obtain other sources of funding from the financial institution providing the reverse factoring arrangement. If the entity were to encounter any difficulty in meeting its obligations, such a concentration would increase the risk that the entity may have to pay a significant amount, at one time, to one counterparty.
b. some suppliers may have become accustomed to, or reliant on, earlier payment of their trade receivables under the reverse factoring arrangement. If the financial institution were to withdraw the reverse factoring arrangement, those suppliers could demand shorter credit terms. Shorter credit terms could affect the entity's ability to settle liabilities, particularly if the entity were already in financial distress.

Paragraphs 33-35 of IFRS 7 require an entity to disclose how exposures to risk arising from financial instruments including liquidity risk arise, the entity's objectives, policies and processes for managing the risk, summary quantitative data about the entity's exposure to liquidity risk at the end of the reporting period (including further information if this data is unrepresentative of the entity's exposure to liquidity risk during the period), and concentrations of risk. Paragraphs 39 and B11F of IFRS 7 specify further requirements and factors an entity might consider in providing liquidity risk disclosures.

An entity applies judgement in determining whether to provide additional disclosures in the notes about the effect of reverse factoring arrangements on its financial position, financial performance and cash flows. The Committee observed that:

a. assessing how to present liabilities and cash flows related to reverse factoring arrangements may involve judgement. An entity discloses judgements that management has made in this respect if they are among the judgements made that have the most significant effect on the amounts recognised in the financial statements (paragraph 122 of IAS 1).
b. reverse factoring arrangements may have a material effect on an entity's financial statements. An entity provides information about reverse factoring arrangements in its financial statements to the extent that such information is relevant to an understanding of any of those financial statements (paragraph 112 of IAS 1).

The Committee noted that making materiality judgements involves both quantitative and qualitative considerations.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the presentation of liabilities that are part of reverse factoring arrangements, the presentation of the related cash flows, and the information to disclose in the notes about, for example, liquidity risks that arise in such arrangements. Consequently, the Committee [decided] not to add these matters to its standard-setting agenda.

Narrow-scope standard-setting

Committee members provided their views on a possible narrow-scope standard-setting project to develop disclosure requirements for arrangements entered into to fund payables to suppliers. The Committee was not asked to make any decisions.

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.

Sale and Leaseback with Variable Payments (IFRS 16 *Leases*)—Agenda Paper 3

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), with (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 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 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).*

Applying paragraph 100(a), the right-of-use asset would not be measured at zero at the date of the transaction because zero would not reflect the proportion of the previous carrying amount of the PPE (CU1,000,000) that relates to the right of use retained by Seller-lessee.

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. 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.

Deferred Tax related to an Investment in a Subsidiary (IAS 12 *Income Taxes*)—Agenda Paper 4

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 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 a current or deferred tax asset or liability 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.

Player Transfer Payments (IAS 38 *Intangible Assets*)—Agenda Paper 5

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

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

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

Recognition of transfer payment received

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

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

Does the transfer payment represent disposal proceeds?

The transfer payment arises from the transfer agreement, which requires the entity to release the player from the employment contract. The entity is therefore required to undertake some action for the right to be extinguished. Accordingly, the transfer payment compensates the entity for its action in disposing of the registration right and, thus, is part of the net disposal proceeds described in paragraph 113 of IAS 38.

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

Statement of cash flows

IAS 7 *Statement of Cash Flows* lists cash receipts from sales of intangibles as an example of cash flows arising from investing activities. Accordingly, in the fact pattern described in the request, the entity presents cash receipts from transfer payments as part of investing activities.

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

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 June 2020.