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IFRS Interpretations Committee

Meeting Notes

November 2022

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Preview

The IFRS Interpretations Committee (IFRS IC) met on 29 November 2022.

The IFRS IC discussed one new item, six potential annual improvements to IFRS Accounting Standards and an item for input on an IASB project.

New item: IFRS 16 *Leases*—Definition of a Lease: Substitution Rights: The IFRS IC received a submission about how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights and at what level an entity evaluates whether that right is substantive. The contract in the fact pattern is for the use of 100 similar assets. The supplier has the practical ability to substitute alternative assets throughout the period of use but is expected to benefit economically from the exercise of its right to substitute only after some time into the period of the lease. The IFRS IC members generally agreed with the staff conclusion that there is an identified asset because the supplier's substitution right is not substantive but had various comments on how the tentative agenda decision analyses it and reaches that conclusion. Most of the IFRS IC members agreed that the level to evaluate whether the substitution right is substantive is on each asset. The IFRS IC voted in favour of not adding a standard-setting project to the work plan and instead to publish a tentative agenda decision, with the drafting amended to take comments into consideration that have been raised by IFRS IC members during the meeting.

Potential annual improvements to IFRS Accounting Standards: The IFRS IC members shared their views on the staff's preliminary views on the following six proposed amendments to IFRS Accounting Standards and to include them in the next annual improvements cycle:

- IFRS 1 *First-time Adoption of International Financial Reporting Standards*—terminology update
- IFRS 10 *Consolidated Financial Statements*—'De facto agent' assessment
- IFRS 9 *Financial Instruments*—terminology update
- IAS 7 *Statement of Cash Flows*—terminology update
- IFRS 7 *Financial Instruments: Disclosures*—reference update
- IFRS 7 *Financial Instruments: Disclosures*—implementation guidance

Input on IASB project: Post-implementation Review (PIR) of IFRS 15 *Revenue from Contracts with Customers*: The IASB has started the PIR of IFRS 15 which aims at assessing whether the effects of applying new requirements on users of financial statements, preparers, auditors and regulators are as intended when the IASB developed those requirements. The IFRS IC members shared their views on the implementation and ongoing application of IFRS 15, including the matters that the IFRS IC members think the IASB should consider in the PIR of the Standard.

Work in progress: There are two new matters that have not been presented to the IFRS IC.

Initial consideration

IFRS 16 *Leases*—Definition of a Lease: Substitution Rights (Agenda Paper 2)

Background

The IFRS IC received a submission about how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights. In the fact pattern, a customer enters into a 10-year contract with a supplier for the use of 100 similar assets (batteries in electric buses). The supplier has the practical ability to substitute alternative assets throughout the 10-year contract term. If an asset were to be substituted, the supplier would be required to indemnify the customer for any revenue lost or costs incurred while the substitution takes place. For this reason, it is expected that the supplier could benefit economically from substituting an asset only when the buses are in the workshop for maintenance or other reasons. At inception of the contract, that event is not considered likely to occur in the first three years of the contract.

The submission asked:

- What the implications are if the supplier:

    - Has the practical ability to substitute alternative assets throughout the period of use but
    - Is expected to benefit economically from the exercise of its right to substitute the asset only on the occurrence of events or circumstances that are not considered likely to occur until some time into the contract term
- If a contract is for the use of multiple similar assets, at what level an entity evaluates whether the supplier's substitution right is substantive—by considering each asset separately or all assets together

Staff analysis

From the outreach performed on the first question, most respondents said that the submitted fact pattern is not common in their jurisdictions. Some respondents said supplier substitution rights—different from those described in the submitted fact pattern—are generally common in practice. The two respondents who observed fact patterns similar to the one submitted said they there is diversity in how customers account for such contracts.

For the second question, some respondents said they were aware of different views regarding the level at which to assess whether supplier substitution rights are substantive. Portfolio application, portions of assets and separate lease components approach set out in paragraphs B1, B20 and B32 of IFRS 16 respectively are applied by different entities.

IFRS 16:B13-B19 provide guidance to assess whether the substitution right is substantial to respond to the first question. The staff views this guidance as a high threshold for a customer to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The staff state that a customer must demonstrate that a supplier's substitution right is substantive—in particular, when the asset is located at the customer's premises. The staff considered that both conditions in IFRS 16.B14(a)-(b) have to exist throughout the period of use in order to demonstrate the substitution right is substantial.

Some people may hold an alternative view in reading IFRS 16:B13-B19 and considered that the supplier must have the practical ability to substitute alternative assets throughout the period of use (as required in IFRS 16:B14(a)) but only needs to be able to benefit economically from exercising its substitution right at some point during the period of use. Therefore, the substitution right in the fact pattern is substantial and there is no identified asset. However, the staff disagrees with this view because the substitution right is not substantive throughout the period of use given the supplier would not benefit economically from exercising its right in the first three years of the contract. They were of the view that IFRS 16:B14 requires such a right to be in existence throughout the period of use, which is not the case in the fact pattern. Furthermore, IFRS 16:BC112 reiterates that the supplier controls the use of an asset if it can substitute the asset throughout the period of use. It would be inappropriate to imply that there is no lease if the supplier has the substantive right to substitute the asset for any part of the contract term. In view of these considerations, the staff concluded that there is an identified asset in the fact pattern submitted because the asset is specified and the supplier's substitution right is not substantive throughout the period of use.

IFRS 16:B12 requires an entity to assess whether a contract contains a lease for each potential "separate lease component" and IFRS 16:B32 provides guidance on the identification of separate lease components. Applying these to the second question, the contract in the fact pattern is for the use of 100 similar assets (i.e. batteries used in electric buses). The customer is able to benefit from use of each battery together with other resources (i.e. a bus) available to it and each battery is neither highly dependent on, nor highly interrelated with, the other batteries in the contract. The staff thus concluded that, the customer assesses whether the contract contains a lease—including evaluating whether the supplier's substitution right is substantive—for each asset.

Staff recommendation

The staff recommended that the IFRS IC do not add a standard-setting project to its agenda and instead publish a tentative agenda decision that outlines the applicable requirements in IFRS 16 and how a customer applies those requirements in the submitted fact pattern.

IFRS IC discussion

There was a lively debate and IFRS IC members contributed meaningful suggestions on how the agenda decision should be drafted to articulate the principle or objective in IFRS 16 for assessing whether there is a substantive substitution right and deliver educational guidance. IFRS IC members generally agreed with the conclusion that the contract contains a lease in the fact pattern submitted but had various comments on the analysis in the agenda decision to get to that conclusion.

Some of the IFRS IC members were not convinced that both of the criteria in IFRS 16:B14(a)-(b) have to exist "throughout the period of use" because such phrase only appears in (a) but not in (b) of IFRS 16:B14. There was no much guidance as to whether the condition in (b) of IFRS 16:B14 is met if the economic benefit exists at some points in time. A number of IFRS IC members agreed with this and added that it was the analysis of the factors in IFRS 16:B15-B19 that helps to conclude or support in assessing whether the supplier has control over the assets. For example, if the batteries are kept on the premises of the customer and there is a practicability issue in replacing them as indicated by IFRS 16:B17. In that case, the replacement is maintenance which does not preclude the customer from having the right of use as indicated in IFRS 16:B18 and the substitution right is not obvious as indicated in IFRS 16:B19. It follows that there is a substantive substitution right applying IFRS 16:B14. IFRS IC members commented that instead of singling out IFRS 16:B14, the staff should have laid out the thought process and taken into consideration the factors in IFRS 16:B15-B19 collectively in order to arrive at its conclusion in the agenda decision.

Most of the IFRS IC members said that the agenda decision may result in a misunderstanding that the condition in IFRS 16:B14(b) has to exist during every single moment of the period of use. Some IFRS IC members said it would be useful to use the example in IFRS 16:BC115 to illustrate a scenario in which the economic benefit only exists during a period that is too short (in the example, 6 months out of 15 years of lease). One IFRS IC member said that if the economic benefit exists during the majority of the lease term, the conclusion may be different. Therefore, these IFRS IC members said that judgement is required to determine whether the benefit exits "throughout the period of use" instead of the benefit having to exist at every single moment. They suggested to explain this in the agenda decision.

One IFRS IC member pointed out that the first sentence of IFRS 16:B16 states that "… 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." He believes that this should be read as both conditions in IFRS 16:B14(a)-(b) need to exist "throughout the period of use" because the conditions help determining whether the right is substantive.

Some IFRS IC members, on the other hand, doubted whether the condition in IFRS 16:B14(a) is met given the batteries are kept on the customer's premises and it is the customer who control where the buses go. It looks like the supplier may not have the practical ability to substitute when the customer controls where the batteries are.

The staff clarified that when the IASB developed IFRS 16, it intentionally set a high hurdle for "substantive" substitution rights to be met. The first paragraph of IFRS 16:B14 fits the objective of the IASB by saying that the right has to be "throughout the period of use" and IFRS 16:B19 says that if the right is not obviously substantive, the entity should assume that it is not. It is not surprising that the conclusion is that the substitution right is not substantial in the fact pattern submitted given the right is not obviously substantive. Having said that, staff agreed with the IFRS IC members' comments on the analysis, and will amend the drafting of the agenda decision to walk through the thought process with consideration of the factors in IFRS 16:B15-19 instead of focusing on IFRS 16:B14 only.

Only a few IFRS IC members commented on the unit of account. They generally agreed with the conclusion and the analysis in the agenda paper that the unit of account is a single battery. Only one IFRS IC member said she believes the unit of account should be the entire contract. The staff explained that the unit of account does not depend on how the entity manages or runs its business.

IFRS IC decision

10 out of 14 IFRS IC members agreed with the conclusion that the contract contains a lease and all IFRS IC members agreed that the unit of account is the single battery. The staff will amend the drafting of the tentative agenda decision before it is published.

Potential annual improvements to IFRS Accounting Standards

The staff asked whether the IFRS IC members agree with their preliminary views on the following six proposed amendments to IFRS Accounting Standards and whether to include them in the next annual improvements cycle. If not, they asked whether IFRS IC members have any other suggestions on them.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* terminology update: Initial consideration (Agenda Paper 3A)

The Committed has been informed about potential confusion arising from an inconsistency in wording between IFRS 1:B6 and requirements for hedge accounting in IFRS 9. The staff propose that the IASB amends IFRS 1:B6 to replace “conditions” with “qualifying criteria” and amend IFRS 1:B5-B6 to add cross references to requirements in IFRS 9.

IFRS IC discussion

Two IFRS IC members suggested adding a reference to other paragraphs in section 6 of IFRS 9 to IFRS 1:B5 because they considered those paragraphs are more appropriate than the ones proposed. However, the staff explained that the IASB did not intend to change the requirements—or the two-step approach—in IFRS 1:B5 or B6. They only replaced the referenced paragraphs in IAS 39 with the relevant paragraphs in IFRS 9. Therefore, the staff suggested keeping the proposed referencing to IFRS 9:6.4.1(a)-(c) for “eligibility” and “qualifying criteria” in IFRS 1:B5 and B6 respectively. Most of the IFRS IC members agreed with this.

'De facto agent’ assessment (IFRS 10 *Consolidated Financial Statements*): Initial consideration (Agenda Paper 3B)

The IFRS IC has been informed about potential confusion arising from an inconsistency between IFRS 10:B73-B74 related to an investor determining whether another party is acting on its behalf. IFRS 10:B73 states the principle—that a de facto agent is a party that acts on the investor’s behalf—and that the determination of whether other parties are acting as de facto agents requires judgement. However, the second sentence of IFRS10:B74 includes more conclusive language. The staff propose that the IASB amends IFRS 10:B74 by deleting a portion of the second sentence of IFRS 10:B74 (i.e. “or those that direct the activities of the investor have”) and remove the opening words of the third sentence (i.e. “In these circumstances,”).

IFRS IC discussion

A number of IFRS IC members acknowledged the issue about the relationship in the existing IFRS 10:B74 and agreed that this paragraph should be amended. However, they commented that the proposed amendments might go beyond an annual improvement project and may bring unintended consequences. Applying the existing IFRS 10:B74, entities exercise judgement to conclude whether sister entities control and consolidate an investee. In the scenario, the sister entities within a group have dispersed interests over the investee. The proposed amendments could be misinterpreted as suggesting that no judgement should be applied. This calls into question how entities applied judgement in such scenarios previously and whether this could have resulted in none of the sister entities consolidating the investee. One IFRS IC member suggested that the staff should either consider different words to clarify that one group entity controls the investee or to perform more analysis and propose another, more extensive, project. The Chair acknowledged these comments and said that they will be raised with the IASB.

IFRS 9 *Financial Instruments* terminology update: Initial consideration (Agenda Paper 3C)

The IFRS IC has been informed about potential confusion arising from a reference in Appendix A of IFRS 9 to the definition of 'transaction price' in IFRS 15. The potential for confusion arises because the term 'transaction price' is used in particular paragraphs of IFRS 9 with a meaning that is not necessarily consistent with the definition of that term in IFRS 15. The staff propose that the IASB deletes the reference to "transaction price" and the associated references to IFRS 15 from Appendix A of IFRS 9.

IFRS IC discussion

One IFRS IC member commented that, in addition to the amendments proposed, the reference to IFRS 15 in IFRS 9:5.1.3 for "transaction price" should be deleted. He explained that Example 40 in the Illustrative Examples of IFRS 15 illustrates that the "transaction price" could lower the receivables amount, so that the "transaction price" in IFRS 9.5.1.13 does not necessarily equal the "actual transaction price" recognised as revenue applying IFRS 15. No IFRS IC member objected to this suggestion.

IAS 7 *Statement of Cash Flows* terminology update: Initial consideration (Agenda Paper 3D)

The IFRS IC has been informed about a potential lack of clarity in IAS 7:37 which arises from the continued use of a term that is no longer defined in IFRS Accounting Standards. The staff proposed that the IASB amend IAS 7:37 to replace the term "cost method" with "at cost".

IFRS IC discussion

One IFRS IC member questioned why only the options "equity method" and "at cost accounting" are stated in IAS 7:37 and not the option "according to IFRS 9" available in IAS 27:10. The Chair said this concern is valid and will be considered. Another IFRS IC member doubted whether it should really be an annual improvement project or whether it is only an editorial change.

IFRS 7 *Financial Instruments: Disclosures* reference update: Initial consideration (Agenda Paper 3E)

The IFRS IC has been informed about a potential lack of clarity in IFRS 7:B38 that arises because it refers to another paragraph in IFRS 7 that no longer exists. The staff propose that the IASB amends IFRS7:B38 to replace the reference to IFRS 7:27A with a reference to IFRS 13:72-73.

IFRS IC discussion

One IFRS IC member commented that this does not look like an annual improvement project and more like an editorial change to the paragraph. The staff responded that it is not only an edit but a change of the reference to another Standard. It would therefore be better to consult whether the new reference is correct. No IFRS IC member objected to the proposed amendment.

IFRS 7 *Financial Instruments: Disclosures* implementation guidance: Initial consideration (Agenda Paper 3F)

The IFRS IC has been informed about a potential lack of clarity in IFRS 7:IG20C because that paragraph fails to state that the example does not illustrate all the requirements in IFRS 7:35M. The staff propose that the IASB amends IFRS 7:IG20C to add a statement that the example does not illustrate all the requirements in IFRS 7:35M.

IFRS IC discussion

One IFRS IC member suggested deleting the sentence "this example does not illustrate…." in IFRS 7:20B instead of adding that sentence to IFRS 7:B20C. Also, it could be added in IFRS 7:IG1 that this paragraph does not include all examples. Another IFRS IC member suggested using the word "some" before "information" would be simpler than adding the lengthy sentence of "this example does not illustrate all the requirements in paragraph 35M of IFRS 7" in IFRS 7:IG20C. One IFRS IC member did also not support adding that sentence because there is no such phrase in other Standards. Even if this means that the example does not illustrate all requirements of the Standards. She therefore suggested removing the phrase in IFRS 7:B20B and instead add an introductory sentence in the IG of IFRS 7 saying "none of the examples in the IG are considered a complete checklist". The Chair agreed with this. However, one IFRS IC member raised concerns that it could be challenged why such introductory sentences do not appear in other Standards. The staff said that a similar sentence appears in newer standards like IFRS 16 and IFRS 17. No IFRS IC member objected to the proposed amendment.

Input on IASB project

Post-implementation Review of IFRS 15 *Revenue from Contracts with Customers* (Agenda Paper 4)

The IASB decided to start the PIR of IFRS 15 in September 2022 and it is at phase 1 of the PIR process (i.e. outreach and information gathering) and expected to publish public request for information in H1 of 2023. The purpose of the PIR is to assess whether the effects of applying new requirements on users of financial statements, preparers, auditors and regulators are as intended when the IASB developed those requirements. The nine areas that the IASB would like to consult on includes each of the steps in five-step revenue recognition model, contracts costs, disclosure, transition and application guidance for principal vs agent and licencing. The staff paper provided detailed information to support outreach for each area consulted. The purpose of the discussion is to ask the IFRS IC members to share views on the implementation and ongoing application of IFRS 15, including the matters that the IFRS IC members think the IASB should consider in the PIR of the Standard. The questions for discussion include the followings:

1. What is your overall assessment of IFRS 15?
    - Does IFRS 15 achieve its objective of establishing the principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers?
    - Do you find the core principle of IFRS 15 and supporting five-step revenue recognition model clear and helpful in making revenue accounting decisions?
2. What are the application matters that you think the IASB should examine during Phase 1 of the PIR and why? It would be most helpful if for each matter you could explain:
    - How prevalent is the matter?
    - What is the cause and what is the effect of the matter?
    - Which companies are affected?
    - Is this matter new, or did it exist under previous revenue requirements?
    - What steps could the IASB take to resolve the matter?
3. How challenging was the transition to IFRS 15 (see slide 24)?
    - Which industries found the transition most challenging and why? Are their issues ongoing?

- In your experience, how often did companies use a modified transition method? Was it more prevalent in some industries than others? Were disclosures provided in the year of application sufficient to explain the transition?

4. Paragraphs BC454–BC493 of the Basis for Conclusions on IFRS 15 set out the IASB's analysis of the likely benefits and costs (effects) of implementing and applying the Standard.

    - Have actual effects differed from the expected effects?
    - Have you observed any other effects of IFRS 15 that were not identified in the effects analysis, for example, effects on the companies' internal controls or on the way the companies conduct their business?

IFRS IC discussion

IFRS IC members expressed their comments on the overall assessment of IFRS 15. They generally considered that IFRS 15 is successful in meeting its objective, is working as intended and is a good framework for analysing revenue. A number of the IFRS IC members considered that IFRS 15 made huge improvements in increasing consistency and comparability in analysis of revenue across different industries and jurisdictions. The 5-step approach is a clear thinking process and is helpful in distinguishing different fact patterns. On the other hand, a few IFRS IC members commented that judgement is involved in the application of the IFRS 15 and this may result in diversity in practice. One IFRS IC member said that IFRS 15 might not be easily understandable for preparers and suggested that the IASB add more guidance and examples in the Standard.

The IFRS IC then discussed application matters that they considered the IASB should examine during Phase 1 of the PIR. A number of IFRS IC members suggested to give guidance on how IFRS 15 interacts with other Standards and which standard takes over to account for a transaction at a certain point in time. Particularly, they asked how the transaction price (e.g. contract assets/liabilities) interacts with IFRS 3 purchase price adjustments, and how IFRS 15 interacts with a corporate wrapper in IFRS 10. They also asked how to determine when the control passes and how the requirements in IFRS 15 are satisfied for a sale and leaseback transaction to pass as a sale. There was also mention of the disclosure requirements in IFRS 15 and how they interact with IAS 34 for interim reports. A few IFRS IC members requested more guidance on the consideration payable to a customer, including how to determine whether a particular payment (e.g. customer incentive) is a reduction of revenue, applying the guidance for consideration payable to customer, or whether it is a marketing expense of the entity. They also asked how to determine whether the service is distinct. Principle vs agent considerations and disclosure requirements were other areas raised by IFRS IC members as requiring further guidance.

The IFRS IC also discussed the benefits and costs of implementing and applying IFRS 15. As for what are the benefits of IFRS 15, a few IFRS IC members thought that the application of IFRS 15 improved the collaboration between the accounting team and the sales team. The accounting team now has more insights in the entities' business when identifying performance obligations in revenue contracts. It also improved the quality and consistency of the accounting treatment of revenue among industries. As for what are the costs of IFRS 15, some IFRS IC members said it was costly and intensive to implement the Standard, and entities would need to allocate resources for upgrading their system to capture information required for measurement and disclosure purposes. One IFRS IC member commented that some entities considered the resources allocated to gathering information for disclosures may not be worthy given the revenue amount does not change no matter how comprehensive the disclosure is. That is why some financial institutions would rather omit those requirements even if they are considered a disclosure deficiencies by their auditors in view. They think that these are not useful to users in that industry.

Regarding the challenges faced on the transition to IFRS 15, only a few IFRS IC members commented that only some practical expedients on transition and the modified approach of disclosure requirements were used by entities. One IFRS IC member wished for more practical expedients for entities to ease the transition process.

Administrative matters

Work in progress (Agenda Paper 5)

The following new matters had not yet been presented to the IFRS IC:

Guarantee over a derivative contract: Whether, applying IFRS 9, an entity accounts for a guarantee over a derivative contract as a financial guarantee contract or a derivative financial instrument.

Homes and home loans provided to employees: How an entity accounts for homes and loans to buy homes provided to its employees.