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IFRS® Foundation

Compilation of Agenda Decisions—Volume 5

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April 2021–October 2021

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Compilation of Agenda Decisions published by the IFRS Interpretations Committee ('The Committee')

Volume 5
(April 2021—October 2021)

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Introduction

Compilation of Agenda Decisions—Volume 5 compiles all agenda decisions published by the IFRS Interpretations Committee (Committee) in the period April 2021 to October 2021. The Committee publishes an agenda decision to explain why a standard-setting project has not been added to the work plan to address a question submitted. For ease of reference, the agenda decisions are sorted by IFRS Standard.

How the Committee supports consistent application of IFRS Standards

The Committee works with the International Accounting Standards Board (Board) in supporting the consistent application of IFRS® Standards.

The Committee's process

Committee projects typically begin as an application question submitted for consideration. The process is designed to:

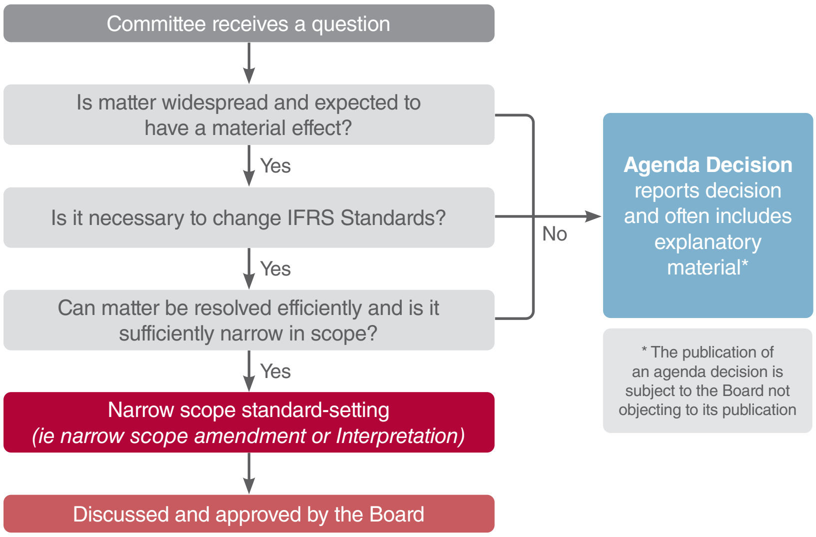
- allow any stakeholder to submit a question for consideration; and
- be transparent—all eligible application questions are considered at a public meeting.

The Committee then decides whether a standard-setting project should be added to the work plan to address the question submitted. The Committee may decide not to do so if it concludes that standard-setting would be:

- unnecessary—typically because, in the Committee's view, IFRS Standards provide an adequate basis for an entity to determine the required accounting or because there is no evidence that a widespread financial reporting problem exists; or
- not sufficiently narrow in scope—the question could be resolved only as part of a larger Board project (not a narrow-scope project).

To explain why a standard-setting project is not added, the Committee publishes an agenda decision. Agenda decisions report the Committee's decision and, in many cases, also include explanatory material.

The following diagram summarises the criteria the Committee considers when deciding whether a standard-setting project should be added to the work plan:



Explanatory material in an agenda decision

Agenda decisions often include explanatory material. The objective of including such explanatory material is to improve the consistency of application of IFRS Standards.

Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.

Explanatory material derives its authority from the Standards themselves. Accordingly, an entity is required to apply the applicable IFRS Standard(s), reflecting the explanatory material in an agenda decision (subject to it having sufficient time to implement that accounting).

Explanatory material included as part of a tentative agenda decision is subject to comment. The comment period is normally 60 days. After considering comments received, the Committee decides whether to confirm its decision and publish an agenda decision (subject to the Board not objecting). An agenda decision is published if no more than three Board members object to its publication. Please visit the project pages on our website if you would like more information about the agenda decisions included in this compilation.

Agenda decisions published by the Committee are available on the 'how we help support consistent application' page.

Narrow-scope standard-setting

Some questions result in narrow-scope standard-setting that follows the applicable due process. The Committee may decide to:

- develop an IFRIC Interpretation, which adds requirements to IFRS Standards but does not remove or replace any requirements in the Standards; or
- recommend that the Board develop a narrow-scope amendment to a Standard.

Narrow-scope standard-setting projects recommended by the Committee and approved by the Board are added to the work plan as maintenance projects.

IFRS 9 *Financial Instruments*

Hedging Variability in Cash Flows due to Real Interest Rates (IFRS 9)

May 2021

The Committee received a request about applying the hedge accounting requirements in IFRS 9 when the risk management objective is to 'fix' the cash flows in real terms.

The request asked whether a hedge of the variability in cash flows arising from changes in the real interest rate, rather than the nominal interest rate, could be accounted for as a cash flow hedge. More specifically, the request describes a fact pattern in which an entity with a floating rate instrument referenced to an interest rate benchmark, such as LIBOR, enters into an inflation swap (which swaps the variable interest cash flows of the floating rate instrument for variable cash flows based on an inflation index). The request asked whether the entity can designate the swap in a cash flow hedging relationship to hedge changes in the variable interest payments for changes in the real interest rate.

Hedge accounting requirements in IFRS 9

Paragraph 6.1.1 of IFRS 9 states that the objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income). Paragraph 6.4.1 of IFRS 9 sets out the qualifying criteria for hedge accounting.

One type of hedging relationship described in paragraph 6.5.2 of IFRS 9 is a cash flow hedge in which an entity hedges the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability and could affect profit or loss.

Paragraph 6.3.7 of IFRS 9 specifies that an entity may designate an item in its entirety, or a component of an item, as a hedged item. A risk component may be designated as the hedged item if, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable.

With respect to inflation risk, paragraph B6.3.13 of IFRS 9 states 'there is a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument'.

Paragraph B6.3.14 of IFRS 9 states that an entity cannot simply impute the terms and conditions of an inflation hedging instrument by projecting its term and conditions onto a nominal interest rate debt instrument. This is because, when developing IFRS 9, the Board specifically considered inflation risk and put in place restrictions to address its concern that entities might impute the terms and conditions of a hedging instrument onto the hedged item 'without proper application of the criteria for designating risk components' as a hedged item (paragraph BC6.193 of IFRS 9). To appropriately account for hedge (in)effectiveness, paragraph B6.5.5 of IFRS 9 requires an entity to measure the (present) value of the hedged item independently of the measurement of the value of the hedging instrument.

Given that the request asked whether the real interest rate component could be designated as a risk component in a cash flow hedge, the Committee's analysis focused on whether a non-contractually specified real interest rate risk component is separately identifiable and reliably measurable in the context of the proposed cash flow hedging relationship described in the request.

Can a non-contractually specified real interest rate risk component be designated as the hedged item in the proposed cash flow hedging relationship?

When considering the qualifying criteria in paragraph 6.4.1 of IFRS 9, the Committee observed that for cash flow hedge accounting to be applied in the fact pattern described in the request, it would be necessary to determine:

- whether that risk component is separately identifiable and reliably measurable as required by paragraph 6.3.7 of IFRS 9; and
- as a result, that the entity has exposure to variability in cash flows that is attributable to the real interest rate risk component of the floating rate instrument as required by paragraph 6.5.2(b) of IFRS 9.

The Committee noted that, to designate a risk component in a hedging relationship, the risk component must be separately identifiable and reliably measurable within the context of each individual hedging relationship. The Committee also noted that it is the market structure—in which a floating rate instrument is issued and in which hedging activity will take place—that needs to support the eligibility of a real interest rate risk component as a non-contractually specified risk component as required by paragraph 6.3.7 of IFRS 9. For the market structure to support the eligibility of that risk component in the proposed cash flow hedging relationship, the real interest rate must represent an identifiable pricing element in setting the floating benchmark interest rate, thereby creating separately identifiable and reliably measurable cash flow variability in the floating rate instrument.

Although the rebuttable presumption in paragraph B6.3.13 of IFRS 9 applies to both fair value hedges and cash flow hedges, the example in paragraph B6.3.14 of IFRS 9 illustrates a rebuttal of the presumption in a fair value hedge. The Committee therefore concluded that, because nominal rates generally do not change as a direct result of changes in real interest rates, the existence in the relevant debt market of a term structure of zero-coupon real interest rates does not, in itself, overcome the rebuttable presumption in paragraph B6.3.13 of IFRS 9 in the proposed cash flow hedging relationship.

The Committee noted that cash flows as defined by paragraph 6 of IAS 7 *Statement of Cash Flows* are, by nature, denominated in nominal terms. The Committee also noted that the interest rate for floating rate financial instruments is defined in nominal terms for a given currency. Therefore, to meet the requirements in IFRS 9 for a cash flow hedge designation, the variability in the cash flows of the floating rate instrument attributable to the designated risk component needs to be assessed in nominal terms. A nominal interest rate (such as LIBOR) may be influenced by expected inflation and the real interest rate in the long term. However, nominal interest rates do not change as a direct result of changes in inflation or the real interest rate (that is, they are not identifiable pricing elements in setting nominal rates).

The Committee therefore concluded that there is no exposure to variability in cash flows that is attributable to changes in the real interest rate in the proposed cash flow hedging relationship and, thus, the requirements in paragraph 6.3.7 and paragraph 6.5.2(b) of IFRS 9 are not met. Consequently, the real interest rate risk component in the proposed cash flow hedging relationship does not meet the requirements in IFRS 9 to be designated as an eligible hedged item as required by paragraph 6.4.1 of IFRS 9.

The Committee concluded that the requirements in IFRS 9 provide an adequate basis for an entity to determine whether a hedge of the variability in cash flows arising from changes in the real interest rate, rather than the nominal interest rate, could be accounted for as a cash flow hedge. Consequently, the Committee decided not to add a standard-setting project to the work plan.

IFRS 16 *Leases*

Non-refundable Value Added Tax on Lease Payments (IFRS 16)

October 2021

The Committee received a request about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. In the fact pattern described in the request:

a. the lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.

b. the applicable legislation:

    i. requires a seller to collect VAT and remit it to the government; and

    ii. generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.

c. because of the nature of its operations, the lessee can recover only a portion of the VAT charged on purchased goods or services. This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.

d. lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.

Outreach conducted by the Committee and comment letters on the Committee's tentative agenda decision provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and

b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

The Committee has therefore not received evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee decided not to add a standard-setting project to the work plan.

IAS 2 *Inventories*

Costs Necessary to Sell Inventories (IAS 2)

June 2021

The Committee received a request about the costs an entity includes as the ‘estimated costs necessary to make the sale’ when determining the net realisable value of inventories. In particular, the request asked whether an entity includes all costs necessary to make the sale or only those that are incremental to the sale.

Paragraph 6 of IAS 2 defines net realisable value as ‘the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale’. Paragraphs 28–33 of IAS 2 include further requirements about how an entity estimates the net realisable value of inventories. Those paragraphs do not identify which specific costs are ‘necessary to make the sale’ of inventories. However, paragraph 28 of IAS 2 describes the objective of writing inventories down to their net realisable value—that objective is to avoid inventories being carried ‘in excess of amounts expected to be realised from their sale’.

The Committee observed that, when determining the net realisable value of inventories, IAS 2 requires an entity to estimate the costs necessary to make the sale. This requirement does not allow an entity to limit such costs to only those that are incremental, thereby potentially excluding costs the entity must incur to sell its inventories but that are not incremental to a particular sale. Including only incremental costs could fail to achieve the objective set out in paragraph 28 of IAS 2.

The Committee concluded that, when determining the net realisable value of inventories, an entity estimates the costs necessary to make the sale in the ordinary course of business. An entity uses its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine whether the estimated costs necessary to make the sale are limited to incremental costs when determining the net realisable value of inventories. Consequently, the Committee decided not to add a standard-setting project to the work plan.

IAS 10 *Events after the Reporting Period*

Preparation of Financial Statements when an Entity is No Longer a Going Concern (IAS 10)

June 2021

The Committee received a request about the accounting applied by an entity that is no longer a going concern (as described in paragraph 25 of IAS 1 *Presentation of Financial Statements*). The request asked whether such an entity:

a. can prepare financial statements for prior periods on a going concern basis if it was a going concern in those periods and has not previously prepared financial statements for those periods (Question I); and

b. restates comparative information to reflect the basis of accounting used in preparing the current period's financial statements if it had previously issued financial statements for the comparative period on a going concern basis (Question II).

Question I

Paragraph 25 of IAS 1 requires an entity to prepare financial statements on a going concern basis 'unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so'. Paragraph 14 of IAS 10 states that 'an entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so'.

Applying paragraph 25 of IAS 1 and paragraph 14 of IAS 10, an entity that is no longer a going concern cannot prepare financial statements (including those for prior periods that have not yet been authorised for issue) on a going concern basis.

The Committee therefore concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity that is no longer a going concern to determine whether it prepares its financial statements on a going concern basis.

Question II

Based on its research, the Committee observed no diversity in the application of IFRS Standards with respect to Question II. Therefore, the Committee has not obtained evidence that the matter has widespread effect.

For the reasons noted above, the Committee decided not to add a standard-setting project on these matters to the work plan.

IAS 19 *Employee Benefits*

Attributing Benefit to Periods of Service (IAS 19)

May 2021

The Committee received a request about the periods of service to which an entity attributes benefit for a particular defined benefit plan. Under the terms of the plan:

a. employees are entitled to a lump sum benefit payment when they reach a specified retirement age provided they are employed by the entity when they reach that retirement age; and

b. the amount of the retirement benefit to which an employee is entitled depends on the length of employee service with the entity before the retirement age and is capped at a specified number of consecutive years of service.

To illustrate the fact pattern described in the request, assume an entity sponsors a defined benefit plan for its employees. Under the terms of the plan:

a. employees are entitled to a retirement benefit only when they reach the retirement age of 62 provided they are employed by the entity when they reach that retirement age;

b. the amount of the retirement benefit is calculated as one month of final salary for each year of service with the entity before the retirement age;

c. the retirement benefit is capped at 16 years of service (that is, the maximum retirement benefit to which an employee is entitled is 16 months of final salary); and

d. the retirement benefit is calculated using only the number of consecutive years of employee service with the entity immediately before the retirement age.

Paragraphs 70–74 of IAS 19 require an entity to attribute benefit to periods of service under the plan's benefit formula from the date when employee service first leads to benefits under the plan until the date when further employee service will lead to no material amount of further benefits under the plan. Paragraph 71 requires an entity to attribute benefit to periods in which the obligation to provide post-employment benefits arises. That paragraph also specifies that the obligation arises as employees render services in return for post-employment benefits an entity expects to pay in future reporting periods. Paragraph 72 specifies that employee service before the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service an employee will have to render before becoming entitled to the benefit is reduced.

For the defined benefit plan illustrated in this agenda decision:

a. if an employee joins the entity before the age of 46 (that is, there are more than 16 years before the employee's retirement age), any service the employee renders before the age of 46 does not lead to benefits under the plan. Employee service before the age of 46 affects neither the timing nor the amount of the retirement benefit. Accordingly, the entity's obligation to provide the retirement benefit arises for employee service rendered only from the age of 46.

b. if an employee joins the entity on or after the age of 46, any service the employee renders leads to benefits under the plan. Employee service rendered from the date of employment affects the amount of the retirement benefit. Accordingly, the entity's obligation to provide the retirement benefit arises from the date the employee first renders service.

Paragraph 73 of IAS 19 specifies that an entity's obligation increases until the date when further service by the employee will lead to no material amount of further benefits under the plan. The Committee observed that:

a. each year of service between the age of 46 and the age of 62 leads to further benefits because service rendered in each of those years reduces the amount of future service an employee will have to render before becoming entitled to the retirement benefit.

b. an employee will receive no material amount of further benefits from the age of 62, regardless of the age at which the employee joins the entity. The entity therefore attributes retirement benefit only until the age of 62.

Consequently, for the defined benefit plan illustrated in this agenda decision, the Committee concluded that the entity attributes retirement benefit to each year in which an employee renders service from the age of 46 to the age of 62 (or, if employment commences on or after the age of 46, from the date the employee first renders service to the age of 62). The Committee's conclusion aligns with the outcome set out in the first part of Example 2 illustrating paragraph 73 (that is, for employees who join before the age of 35), which is part of IAS 19.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the periods to which retirement benefit is attributed in the fact pattern described in the request. Consequently, the Committee decided not to add a standard-setting project to the work plan.

IAS 32 *Financial Instruments: Presentation*

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32)

October 2021

The Committee received a request about the application of IAS 32 in relation to the reclassification of warrants. Specifically, the request described a warrant that provides the holder with the right to buy a fixed number of equity instruments of the issuer of the warrant for an exercise price that will be fixed at a future date. At initial recognition, because of the variability in the exercise price, the issuer in applying paragraph 16 of IAS 32 classifies these instruments as financial liabilities. This is because for a derivative financial instrument to be classified as equity, it must be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments ('fixed-for-fixed condition'). The request asked whether the issuer reclassifies the warrant as an equity instrument following the fixing of the warrant's exercise price after initial recognition as specified in the contract, given that the fixed-for-fixed condition would at that stage be met.

The Committee observed that IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged. The Committee acknowledged that similar questions about reclassification arise in other circumstances. Reclassification by the issuer has been identified as one of the practice issues the Board will consider addressing in its Financial Instruments with Characteristics of Equity (FICE) project. The Committee concluded that the matter described in the request is, in isolation, too narrow for the Board or the Committee to address in a cost-effective manner. Instead, the Board should consider the matter as part of its broader discussions on the FICE project. For these reasons, the Committee decided not to add a standard-setting project to the work plan.

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The International Accounting Standards Board (Board) is the independent standard-setting body of the IFRS® Foundation.

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