HM Treasury

Financial Reporting Advisory Board Paper

IFRS Interpretations Committee meetings – update

Issue:	A summary of the IFRS Interpretations Committee meetings from November 2022-March 2023, noting any particular relevance to the public sector.
Impact on guidance:	Potential adaptation or interpretation in the FReM dependent on outcomes of any Standard Setting adjustments.
IAS/IFRS adaptation?	No adaptations or interpretations proposed but further agenda decisions will be considered as needed.
Impact on WGA?	None.
IPSAS compliant?	This would depend on whether IPSASB make adjustments for any new IFRS amendments and interpretations.
Interpretation for the public-sector context?	No adaptations or interpretations proposed.
Impact on budgetary regime and Estimates?	None.
Alignment with National Accounts	No impact on the National Accounts.
Recommendation:	For the Board to note, HM Treasury proposes to make no adaptations or interpretations in relation to any outcome from the IFRS IC meetings summarised below.
Timing:	Ongoing

DETAIL
Introduction

1. This paper provides the Board with a summary of announcements from the IFRS Interpretations Committee between November 2022 and March 2023. The paper is provided for the Board's information and presented by meeting date in chronological order. The paper covers the main agenda decisions of the Interpretations Committee and tentative agenda decisions. Relevance to the public sector and any impacts on the FReM have been considered and noted.

2. There was one agenda decision and four tentative agenda decisions published since the last update.

    2.1 Agenda decision: Definition of a Lease - Substitution Rights (IFRS 16 Leases)

IFRS Interpretation Committee Update 29 November

3. Committee's tentative agenda decisions which will return to the Committee for further discussion at a later point:

   3.1 Definition of a Lease - Substitution Rights (IFRS 16 Leases) - SEE APPENDIX 1 FOR THE FULL TEXT

   Consideration following a request about how to assess whether a contract contains a lease. The request asked about:

   a) the level at which to evaluate whether a contract contains a lease—by considering each asset separately or all assets together—when the contract is for the use of more than one similar asset.
   b) how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights

   The Committee observed that the requirements in paragraphs B13–B19 set a high hurdle for a customer to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The Committee also observed that determining whether a supplier's right to substitute an asset is substantive throughout the period of use requires judgement.

   The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Therefore, the Committee decided not to add a standard setting project to the work plan.

   No action for the public sector proposed at this time

IFRS Interpretation Committee Update 14-15 March

4. Committee's tentative agenda decisions which will return to the Committee for further discussion at a later point:

   4.1 Guarantee over a Derivative Contract (IFRS 9 Financial Instruments)

   Consideration following a request about whether, in applying IFRS 9, an entity accounts for a guarantee written over a derivative contract as a financial guarantee contract or a derivative. The request described a guarantee written over a derivative contract between two third parties. Such a guarantee would reimburse the holder of the guarantee for the actual loss incurred—up to the close-out amount—in the event of default by the other party. The close-out amount is determined based on a valuation of the remaining contractual cash flows of the derivative prior to default.

   The Committee observed that the matters described in the request are not widespread, and that when the matters do arise, the amounts involved are not material.

The Committee concluded that the matter described in the request does not have widespread effects and it does not have a material effect on those affected. Therefore, the Committee decided not to add a standard setting project to the work plan.

No action for the public sector proposed at this time

4.2 Premiums receivable from an Intermediary (IFRS 17 Insurance Contracts and IFRS 9 Financial Instruments) - SEE APPENDIX 2 FOR THE FULL TEXT

Consideration following a request about how an entity that issues insurance contracts (insurer) applies the requirements in IFRS 17 and IFRS 9 to premiums receivable from an intermediary.

The Committee observed that:

- IFRS 17 is the starting point for an insurer to consider how to account for its right to receive premiums under an insurance contract.
- Paragraph B65 of IFRS 17 does not distinguish between premiums to be collected directly from a policyholder and premiums to be collected through an intermediary.
- IFRS 17 is silent on whether future cash flows within the boundary of an insurance contract are removed from the measurement of a group of insurance contracts only when these cash flows are recovered or settled in cash.
- In accounting for premiums receivable from an intermediary when payment by the policyholder discharges the policyholder's obligation under the insurance contract, an insurer can apply either View 1 or View 2

The Committee concluded that, because IFRS 17 is silent on when future cash flows within the boundary of an insurance contract are removed from the measurement of a group of insurance contracts, in the fact pattern described in the requests, an insurer could account for premiums paid by a policyholder and receivable from an intermediary applying either IFRS 17 or IFRS 9. Therefore, the Committee decided not to add a standard setting project to the work plan.

No action for the public sector proposed at this time

4.3 Homes and Home Loans Provided to Employees - SEE APPENDIX 3 FOR THE FULL TEXT

Consideration following a request about how an entity accounts for employee home ownership plans and employee home loans.

The Committee concluded that the matters described in the request do not have widespread effect and they do not have (and nor are they expected to have) a material effect on those affected. Therefore, the Committee decided not to add a standard setting project to the work plan.

No action for the public sector proposed at this time

Agenda decision for Board consideration:

4.4 Definition of a Lease - Substitution Rights (IFRS 16 Leases)

The Committee considered feedback on the tentative agenda decision published in the November 2022 IFRIC Update about how to assess whether a contract contains a lease.

The Committee concluded its discussions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's Due Process Handbook, the International Accounting Standards Board (IASB) will consider this agenda decision at its April 2023 meeting. If the IASB does not object to the agenda decision, it will be published in April 2023 in an addendum to this IFRIC Update.

Appendix 1

Definition of a Lease—Substitution Rights (IFRS 16 Leases)

The Committee received a request about how to assess whether a contract contains a lease. The request asked about:

a. the level at which to evaluate whether a contract contains a lease—by considering each asset separately or all assets together—when the contract is for the use of more than one similar asset.
b. how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights—i.e. the supplier:
    i. has the practical ability to substitute alternative assets throughout the period of use; but
    ii. would not benefit economically from the exercise of its right to substitute the asset throughout the period of use.

The definition of a lease

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

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

The period of use is 'the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)'. (Appendix A to IFRS 16)

Paragraph B12 of IFRS 16 states that 'an entity shall assess whether a contract contains a lease for each potential separate lease component' and directs an entity to paragraph B32 of IFRS 16 for application guidance on separate lease components. Paragraph B32 specifies that the right to use an underlying asset is a separate lease component if both:

a. the lessee can benefit from use of the underlying asset either on its own or together with other resources readily available to it; and
b. the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

Identified asset

The first requirement for a contract to meet the definition of a lease is that a customer controls the use of an identified asset. Paragraphs B13–B20 of IFRS 16 provide application guidance on an identified asset.

Paragraph B13 states that 'an asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer'.

But ‘even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use’ (paragraph B14). In that case, the supplier—rather than the customer—controls the use of the asset. As a consequence, there is no identified asset; the contract does not contain a lease.

For a substitution right to be *substantive*, paragraph B14 states that both of the following conditions must exist:

a. the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
b. the supplier would benefit economically from the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

Paragraph B16 states that ‘an entity’s evaluation of whether a supplier’s substitution right is substantive excludes consideration of future events that, at inception of the contract, are not considered likely to occur.’

Paragraphs B15–B18 specify requirements that mean, in each of the following situations, a supplier’s substitution right is *not* substantive (or the customer is not precluded from having the right to use an identified asset):

a. the supplier has the right or obligation to substitute the asset only on or after a particular date or the occurrence of a specified event;
b. the supplier would benefit economically from the exercise of its right only on the occurrence of a future event that, at inception of the contract, is not considered likely to occur; or
c. the supplier has the right or obligation to substitute the asset only for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available.

Paragraph B17 notes that the costs of substitution are more likely to exceed the associated benefits when the asset is located at the customer’s premises or elsewhere. Paragraph B19 requires the customer to presume that a supplier’s substitution right is *not* substantive if the customer cannot readily determine whether the supplier has a substantive substitution right.

Paragraph BC113 of the Basis for Conclusions on IFRS 16 explains the IASB’s rationale in developing the requirements on substitution rights and states that ‘the IASB’s intention in including [these requirements] is to differentiate between:

a. substitution rights that result in there being no identified asset because the supplier, rather than the customer, controls the use of an asset; and
b. substitution rights that do not change the substance or character of the contract because it is not likely, or practically or economically feasible, for the supplier to exercise those rights’.

Paragraph BC113 goes on to explain that, at the time of developing IFRS 16, the IASB was of the view ‘that, in many cases, it will be clear that the supplier would not benefit from the exercise of a substitution right because of the costs associated with substituting an asset’. ‘If substitution rights are substantive, then the IASB thinks that this would be relatively clear from the facts and circumstances' (paragraph BC115).

Consequently, the Committee observed that the requirements in paragraphs B13–B19 set a high hurdle for a customer to conclude that there is no identified asset when an asset is explicitly or implicitly specified. The Committee also observed that determining whether a supplier's right to substitute an asset is substantive *throughout* the period of use requires judgement.

Application of the requirements in IFRS 16 to the fact pattern described in the request

In the fact pattern described in the request:

a. *a customer enters into a 10-year contract with a supplier for the use of 100 similar new assets—batteries used in electric buses. The customer uses each battery together with other resources readily available to it (each battery is used in a bus that the customer owns or leases from a party unrelated to the supplier).*
b. *applying the requirements in paragraphs B14–B18, it is determined that the supplier has the practical ability to substitute alternative assets throughout the contract term such that the condition in paragraph B14(a) exists.*
c. *if a battery were to be substituted, the supplier would be required to compensate the customer for any revenue lost or costs incurred while the substitution takes place. Whether substitution is economically beneficial for the supplier at a point in time depends on both the amount of compensation payable to the customer and the condition of the battery. At inception of the contract, it is expected that the supplier would not benefit economically from substituting a battery that has been used for less than three years but could benefit economically from substituting a battery that has been used for three years or more.*

The level at which to evaluate whether a contract contains a lease

In the fact pattern described in the request, the customer is able to benefit from use of each asset (a battery) together with other resources (a bus) available to it and each battery is neither highly dependent on, nor highly interrelated with, the other batteries in the contract.

Therefore, the Committee concluded that, in the fact pattern described in the request, applying paragraph B12, the customer assesses whether the contract contains a lease—including evaluating whether the supplier's substitution right is substantive—for each potential separate lease component, i.e. for each battery.

Identified asset

In the fact pattern described in the request, each battery is specified. Even if not explicitly specified in the contract, a battery would be implicitly specified at the time it is made available for the customer's use. Therefore, the Committee observed that, unless the supplier has the substantive right to substitute the battery throughout the period of use, each battery is an identified asset.

In the fact pattern described in the request, the condition in paragraph B14(a)—the supplier has the practical ability to substitute alternative assets throughout the period of use—is assumed to exist. The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier's substitution right is not substantive throughout the period of use.

Therefore, the Committee concluded that, in the fact pattern described in the request, each battery is an identified asset. To assess whether the contract contains a lease, the customer would then apply the requirements in paragraphs B21–B30 of IFRS 16 to determine whether, throughout the period of use, it has the right to obtain substantially all the economic benefits from use, and direct the use, of each battery.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix 2

Premiums receivable from an Intermediary (IFRS 17 Insurance Contracts and IFRS 9 Financial Instruments)

The Committee received requests about how an entity that issues insurance contracts (insurer) applies the requirements in IFRS 17 and IFRS 9 to premiums receivable from an intermediary.

In the fact pattern described in the request, an intermediary acts as a link between an insurer and a policyholder to arrange an insurance contract between them. The policyholder has paid in cash the premiums to the intermediary, but the insurer has not yet received in cash the premiums from the intermediary. The agreement between the insurer and the intermediary allows the intermediary to collect the premiums to the insurer at a later date.

When the policyholder paid the premiums to the intermediary, the policyholder discharged its obligation under the insurance contract and the insurer is obliged to provide insurance contract services to the policyholder. If the intermediary fails to pay the premiums to the insurer, the insurer does not have the right to recover the premiums from the policyholder, or to cancel the insurance contract.

The requests asked whether, in the submitted fact pattern, the premiums receivable from the intermediary are future cash flows within the boundary of an insurance contract and included in the measurement of the group of insurance contracts applying IFRS 17 or are a separate financial asset applying IFRS 9. The requests set out two views.

Under the first view (View 1), the insurer determines that the premiums receivable from the intermediary are future cash flows within the boundary of an insurance contract. Applying View 1, when the policyholder pays the premiums to the intermediary:

a. for a group of contracts to which the premium allocation approach does not apply, the insurer continues to treat the premiums receivable from the intermediary as future cash flows within the boundary of an insurance contract and, applying IFRS 17, include them in the measurement of the group of insurance contracts until recovered in cash; and
b. for a group of contracts to which the premium allocation approach does apply, the insurer does not increase the liability for remaining coverage—it does so only when it recovers the premiums in cash from the intermediary.

Under the second view (View 2), because the payment by the policyholder discharges its obligation under the insurance contract, the insurer considers the right to receive premiums from the policyholder to be settled by the right to receive premiums from the intermediary. The insurer therefore determines that the premiums receivable from the intermediary are not future cash flows within the boundary of an insurance contract but, instead, a separate financial asset. Applying View 2, when the policyholder pays the premiums to the intermediary:

a. for a group of contracts to which the premium allocation approach does not apply, the insurer removes the premiums from the measurement of the group of insurance contracts and, applying IFRS 9, recognises a separate financial asset; and
b. for a group of contracts to which the premium allocation approach does apply, the insurer increases the liability for remaining coverage and, applying IFRS 9, recognises a separate financial asset.

Applying the requirements in IFRS Accounting Standards

The Committee observed that IFRS 17 is the starting point for an insurer to consider how to account for its right to receive premiums under an insurance contract. The Committee considered:

a. which cash flows are within the boundary of an insurance contract applying IFRS 17;
b. when cash flows are removed from the measurement of a group of insurance contracts; and
c. what information is being provided about credit risk.

Cash flows within the boundary of an insurance contract applying IFRS 17

Paragraph 33 of IFRS 17 requires an insurer to include in the measurement of a group of insurance contracts an estimate of all the future cash flows within the boundary of each contract in the group. Paragraph B65 explains that cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including premiums from a policyholder.

The Committee observed that paragraph B65 of IFRS 17 does not distinguish between premiums to be collected directly from a policyholder and premiums to be collected through an intermediary. In applying IFRS 17, premiums from a policyholder collected through an intermediary is therefore included in the measurement of a group of insurance contracts.

The Committee next considered when the premiums that are already included in the measurement of a group of insurance contracts are removed from that measurement.

Removing cash flows from the measurement of a group of insurance contracts

Paragraph 34 of IFRS 17 specifies that cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with insurance contract services.

In the fact pattern described in the requests, the insurer has not recovered the premiums in cash. The Committee observed that IFRS 17 is silent on whether future cash flows within the boundary of an insurance contract are removed from the measurement of a group of insurance contracts only when these cash flows are recovered or settled in cash.

Therefore, the Committee observed that, in accounting for premiums receivable from an intermediary when payment by the policyholder discharges the policyholder's obligation under the insurance contract, an insurer can apply either View 1 or View 2. Given this, the Committee next considered the implications of both views for information about credit risk.

Information about credit risk

IFRS 17 and IFRS 9 deal differently with the measurement, presentation and disclosure of expected credit losses from an intermediary. The Committee considered that, depending on which view (View 1 or View 2) an insurer applies, it is required to apply all the measurement and disclosure requirements in the applicable IFRS Accounting Standards. Therefore, an insurer applies either IFRS 17 (including paragraph 131 that requires disclosure of information about the credit risk that arises from contracts within the scope of IFRS 17) or IFRS 9 (and the requirements in IFRS 7 *Financial Instruments: Disclosures*) to the premiums receivable from an intermediary.

Conclusion

The Committee concluded that, because IFRS 17 is silent on when future cash flows within the boundary of an insurance contract are removed from the measurement of a group of insurance contracts, in the fact pattern described in the requests, an insurer could account for premiums paid by a policyholder and receivable from an intermediary applying either IFRS 17 or IFRS 9.

In light of its analysis, the Committee considered whether to add a standard-setting project on the interaction between IFRS 17 and IFRS 9 to the work plan. The Committee noted that any such project would involve assessing whether changes to the Standards would have unintended consequences. This assessment may take considerable time and effort to complete because it would involve, among other steps, analysing a broad range of contracts (not only those set out in the fact pattern described in the requests). The Committee observed that the application of either View 1 or View 2 when accounting for premiums paid by a policyholder and receivable from an intermediary would provide users of financial statements with useful information based on the requirements in IFRS 17 or IFRS 9.

Consequently, the Committee concluded that a project would not result in an improvement in financial reporting that would be sufficient to outweigh the costs. The Committee therefore [decided] not to add a standard-setting project to the work plan.

Appendix 3

Homes and Home Loans Provided to Employees

The Committee received a request about how an entity accounts for employee home ownership plans and employee home loans.

Fact pattern 1: employee home ownership plans

An entity provides its employee with a house that the entity constructed and owns. In return, the employee has a proportion of his or her base salary deducted every month until the agreed price of the house has been fully repaid.

If the employee leaves employment *within* the first five years of the arrangement, the employee forfeits his or her rights to the house and recovers the salary deductions to date. If the employee leaves employment *after* that five-year period, the employee may choose either:

a. to forfeit his or her rights to the house and recover the salary deductions to date; or
b. to keep the house and immediately repay the outstanding balance.

Legal title to the house transfers to the employee only when he or she has paid in full the agreed price for the house.

The request asked how the entity should account for this arrangement—in particular, when it should recognise the transfer of the house to the employee, and the accounting before and after the transfer.

Fact pattern 2: employee home loans

An entity provides its employee with a loan to buy a house, which the employee chooses and purchases and the entity does not own. The entity provides the loan at a below-market rate of interest; the loan is typically interest-free. The employee repays the loan through salary deductions. If the employee leaves employment for any reason at any point, the outstanding balance of the loan becomes repayable.

The request asked how the entity should account for this arrangement—in particular, whether the loan is:

a. a prepaid employee benefit within the scope of IAS 19 *Employee Benefits*; or
b. a financial asset within the scope of IFRS 9 *Financial Instruments*, with the below-market element of the loan accounted for as a prepaid employee benefit by applying IAS 19.

Findings

Evidence gathered by the Committee [to date] indicated that the matters described in the request are not widespread, and that when the matters do arise, the amounts involved are not material.

Conclusion

Based on its findings, the Committee concluded that the matters described in the request do not have widespread effect and they do not have (and nor are they expected to have) a material effect on those affected. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.