Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Berlin, 06 February 2019

Dear Sue,

RE: The IFRS IC's tentative agenda decisions in its November 2018 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the November 2018 IFRIC Update.

We agree with four of the tentative agenda decisions. However, in respect of two tentative agenda decisions we have concerns with the decision and the reasons cited, namely the tentative decisions on physical settlement of contracts (IFRS 9) and cloud computing (IAS 38).

Please find our detailed comments in the appendix to this letter. If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

Appendix – Detailed Comments

IFRS 9 – Physical settlement of contracts to buy or sell non-financial items

Whilst we acknowledge that the tentative agenda decision is *one* possible conclusion for the issue submitted, in the absence of specific presentation requirements we do not agree that it is the *only* conclusion possible and that other views may be equally appropriate. We therefore disagree with the tentative decision and with the robust way it is formulated. As we see it, there are two issues that, whilst interrelated, we believe be better addressed separately:

(a) the question of how the amount of revenue from contracts with customers is to be determined in cases where the delivery mechanism occurs in such a way that the promise is treated as a derivative financial instrument because of explicit or de facto net settlement options per IFRS 9.2.6, yet the contracts are never settled net, but are settled physically at the amount specified in the contract with the customer; and
(b) whether or not the specific journal entries enquired by the submitter are appropriate or at least allowable.

On the first issue, treating a commodity contract for the delivery of goods and services as a financial instrument rather than under the revenue recognition literature seems entirely appropriate where such a contract is settled net in cash rather than through physical delivery. The core idea behind the provisions in IFRS 9 (and IAS 39 before) was to scope in contracts that, while taking the legal form of a commodity contract, are, in substance, financial contracts that are referenced to a commodity price. And that idea is clearly appropriate as long as the commodity contracts are settled net in cash.

The issue becomes more complicated as soon as the contract – whilst *allowing* for net settlement – is *actually settled* physically for the stated quantity in exchange for the contracted amount (and even more so for contracts that *mandatorily foresee physical delivery*). Where we do agree with the Committee is that an entity first has to judge whether or not the contract meets the own use exemption. If that is not the case, the contract is deemed a derivative financial instrument and treated as such per IFRS 9. However, IFRS 9 is a standard on recognition and measurement and is almost completely silent on presentation: Whilst we acknowledge that the entity has to mark the contract to fair value and record changes in fair value in profit or loss over the term of the contract, we fail to see anything in the literature that would require entities to derecognize the final derivative balance against the top line in the income statement (or prohibit them from doing so).

We would even go a step further: The seller has a contract with a customer for a specific quantity of goods and services at a specified amount; the seller has not contracted a derivative financial instrument and neither has the other party to the contract. We believe that the substance of the transaction could be misrepresented if the derivative treatment impacted the presentation of revenue to be recognised from the contract with the customer – which the tentative agenda decision seems to suggest when requiring that the revenue amount be presented at the spot price rather than the contracted forward price (effectively a net presentation). Clearly, upon settlement of the contract the entity needs to derecognise the derivative and to recognise the cash received as well as the revenue earned. However, if revenue were to be presented at the spot rather than the forward price, there would be an implicit assumption that the cash coming from the customer would be received for settling a derivative with the customer – which is not the case. The cash is received for providing goods and services, as specified in the contract with the customer. Hence, and in the absence of any specific requirement in IAS 1, IAS 32, IFRS 9 and IFRS 15, we see no basis for not allowing entities to

present the difference between the spot and the forward price outside of the revenue line (a gross presentation).

If one follows our line of thinking, the second issue would become void, as there simply would be no reversals that would have to be recorded: Measurement of the derivative and presentation of its fair value changes would be kept separate from the accounting for the contract with the customer. Whilst this might be perceived odd from proponents of the financial instruments literature, we reiterate our point that provisions around derivative accounting in IFRS 9 and IAS 39 had been drafted with a different scenario in mind, being net settled contracts. For contracts that are not settled net but settled physically there is a gap in the literature as to what the appropriate presentation would be, as IFRS 9 and IAS 39 are silent on this issue. We therefore believe that entities are required to determine an appropriate basis of accounting (including presentation) and apply that basis consistently following IAS 8.

From outreach conducted we understand that both a net and a gross settlement treatment exist, though generally not within a specific industry. For instance, we are aware of the fact that the energy sector in Germany (and Europe) applies the gross treatment presentation mentioned above and, to our knowledge, have never been scrutinized by their auditors or enforcement bodies for doing so. We therefore believe that the agenda decision unduly emphasises one possible view without appropriately considering the other line of argument. In this regard we note that the wording in the tentative agenda decision seems to suggest that those entities who have followed a different line of thinking are not complying with the requirements in IFRS 9 – which we find an inappropriate conclusion: If the Committee acknowledges existing diversity, it should refrain from assuming that entities are consciously taking decisions against the literature. If the literature is not entirely clear and can be interpreted in different ways, some of which the Committee deems unacceptable, we believe that an agenda decision is the wrong means to address this behavior.

Hence, we request the Committee reconsider their tentative decision and either change their wording or take the issue onto its agenda and deal with it with the normal due process in place. If the Committee came to the conclusion that they would like to see further facts to better understand how the other view is applied in practice, we stand ready to assist the Committee and staff and share our evidence.

IFRS 16 / IAS 38 – Rights to access the supplier's software hosted on the cloud

We deem the tentative agenda decision not adding sufficient clarity to this complex issue. In particular, we do not agree with the finding that "the requirements in existing IFRSs provide an adequate basis". This is because the decision refers to software as a service (SaaS), as the agenda paper acknowledges. However, there is a broad variety of agreements on SaaS, as well as infrastructure as a service (IaaS) or platform as a service (PaaS). Even more prevalent are agreements that comprise multiple services/elements, and to make the picture complete, there are agreements under which the individual elements software and infrastructure are not managed and provided by the very same counterparty. With that in mind, the decision and its rationale do not seem to provide sufficient clarity for judging the many other fact patterns, even if they are close to the fact pattern in the submission.

Further, we are not convinced by the line of argument, which suggests a sequence as to how one should apply existing requirements in assessing whether or not there is an asset to be recognised (and if so, what kind of asset). In particular, we do not find the initial step of assessing the applicability of IFRS 16 intuitive, i.e. assessing the nature of the agreement (is it a lease or not). To us, it appears equally or even more appropriate if the first step were to assess the applicability of IAS 38. Further, we deem the reference to IFRS 15.B58 et seqq. to be inadequate. Our view is that these requirements had been drafted to help assessing whether the nature of the promise is a performance obligation being satisfied over time or at a point in time, while the focal point here is whether the asset, if any, is a right to access or a right to use (for which, at best, IFRS 15.B56 is relevant). The Committee's usage of a *right to access* corresponding with no asset recognition and *right to use* corresponding with asset recognition (a lease) therefore does not seem to have the right anchor.

In light of this, we would appreciate if the IFRS IC consider changes in the wording of its final decision aiming at more clearly addressing the variety of (other) fact patterns and aiming at better structuring the questions to be asked (i.e. asset or not, nature of the asset, nature of the agreement etc.) as well as the respective IFRS requirements to be assessed.