

Prepayments in long-term supply contract (IAS 2 *Inventories*)—November 2015

The Interpretations Committee received a request seeking clarification on the accounting for long-term supply contracts for inventories when the purchaser agrees to make significant prepayments to the supplier. The question considered is whether the purchaser should accrete interest on long-term prepayments by recognising interest income, resulting in an increase in the cost of inventories and, ultimately, the cost of sales.

The Interpretations Committee discussed this issue and noted that paragraph 18 of IAS 2 *Inventories* requires that when an entity purchases inventories on deferred settlement terms, and the arrangement contains a financing element, the difference between the purchase price on normal credit terms and the amount paid is recognised separately as interest expense over the period of the financing. It also noted that IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* include similar requirements when payment for an asset is deferred. IFRS 15 *Revenue from Contracts with Customers*, issued in May 2014, additionally includes the requirement that the financing component of a transaction should be recognised separately in circumstances of both prepayment and deferral of payment.

The Interpretations Committee conducted outreach on this issue, but the outreach returned very limited results. In the absence of evidence about this issue, and of a broader range of information about the facts and circumstances relating to these transactions, the Interpretations Committee thought it would be difficult for it to address this topic efficiently and effectively. The Interpretations Committee observed, however, that when a financing component is identified in a long-term supply contract, that financing component should be accounted for separately. The Interpretations Committee acknowledged that judgement is required to identify when individual arrangements contain a financing component.

The Interpretations Committee concluded that this issue did not meet its agenda criteria and therefore it decided to remove this issue from its agenda.