IFRS

STAFF PAPER

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Project	Commodities		
Paper topic	Commodity loans		
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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify the accounting for commodity loan transactions. Specifically, the Interpretations Committee was asked to consider a fact pattern in which an entity borrows a commodity from another entity, and separately lends the same commodity to a third entity for the same period and for a higher fee.
2. The objective of this Agenda Paper is to provide the Interpretations Committee with a summary of the issue and the staff's research, analysis and recommendation.
3. The submission is reproduced in Appendix B to this paper.

Structure of the paper

4. This paper is organised as follows:
   (a) background information;
   (b) summary of outreach conducted;
   (c) staff analysis—existing requirements in IFRS Standards;
   (d) staff analysis—application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;

(e) assessment against the Interpretations Committee's agenda criteria;

(f) staff recommendation;

(g) questions for the Interpretations Committee;

(h) Appendix A—Proposed wording for a tentative agenda decision; and

(i) Appendix B—Submission.

Background information

5. The submitter describes a scenario in which:

   (a) *Reporting Entity* (often a bank) borrows a commodity (gold[1]) from *Lender* (often another bank) for 12 months (referred to as Transaction #1). On physical receipt of the commodity, legal title passes to Reporting Entity. The commodity is fungible and can easily be replaced with a similar commodity (another bar of gold).

   (b) There are no cash inflows or outflows at inception of Transaction #1. Instead, Reporting Entity pays a fixed quarterly fee to Lender for the duration of the contract based on (i) the value of the commodity at inception; and (ii) relevant interest rates at inception. At maturity, Reporting Entity is obliged to deliver a commodity of the same type, quantity and quality to Lender. Reporting Entity may, or may not, have an option to settle its obligation in cash, on the basis of the spot price of the commodity at maturity.

   (c) Reporting Entity then enters into a similar transaction with *Borrower* (referred to as Transaction #2). In Transaction #2, legal title of the commodity is transferred to Borrower under the same terms and conditions described in Transaction #1, but for a higher fixed fee from Borrower to Reporting Entity.

[1] The fact pattern described in the submission is a gold transaction. The issue identified could involve other commodities. Thus the term 'commodity' is used throughout this paper, unless we are referring specifically to gold.

6. A diagram illustrating the transactions is included within the submission in Appendix B to this paper. It is assumed that all three parties to the transactions are unrelated to each other. It is also assumed that Reporting Entity negotiates each transaction independently of the other (ie Borrower and Lender are unaware of the other's transaction with Reporting Entity), although Reporting Entity is likely to have entered into both transactions in contemplation of the other.

7. The submitter asks whether Reporting Entity is required to recognise an asset and a liability in respect of these transactions.

8. The submitter has observed the following two reporting methods in practice:

   (a) View 1— Reporting Entity recognises both:

      (i) an asset (representing the commodity received from Lender in Transaction #1 – albeit that this might be reclassified as 'inventory to be received' following Transaction #2); and

      (ii) a liability (representing the contractual obligation to return the commodity to Lender).

   (b) View 2— Reporting Entity does not recognise an asset or a liability on receipt of the commodity from Lender in Transaction #1, nor does it recognise anything on transfer of the commodity to Borrower in Transaction #2. Instead, it accounts only for the predetermined fixed fees as an expense over the term of the arrangement with Lender, and as service fee income over the term of the arrangement with Borrower.

View 1—Recognise an asset (representing the commodity or commodity receivable) and a liability (representing the contractual obligation to return a commodity)

9. According to the submitter, an entity adopting this approach would generally account for the commodity transaction as inventory applying IAS 2 *Inventories*.

10. According to the submitter, proponents of this view say the following:

   (a) The commodity received from Lender meets the definition of an asset for Reporting Entity applying paragraph 4.4(a) of the Conceptual

Framework for Financial Reporting (the *Conceptual Framework*). This is because:

(i) Reporting Entity obtains control of the commodity when it receives the commodity from Lender. Because the commodity is highly liquid and readily convertible into cash, Reporting Entity can easily obtain the same quantity and quality of the commodity in the market to return to Lender at the settlement date – there are no restrictions on Reporting Entity's use of the commodity from the date on which it receives the commodity.

(ii) Reporting Entity obtains the commodity principally for the purpose of generating profits by lending it to another entity and charging higher fees. Future economic benefits will flow to Reporting Entity when it lends the commodity to Borrower.

(b) Similarly, the obligation to deliver a commodity to Lender at the end of the contract term meets the definition of a liability. This is because (i) the obligation arises as a result of the borrowing transaction with Lender; and (ii) the obligation exists regardless of what Reporting Entity does with the commodity during the contract term.

(c) The transaction between Reporting Entity and Borrower does not meet the definition of a 'sale' of inventory applying either IAS 18 *Revenue* or IFRS 15 *Revenue from Contracts with Customers*. This is because the significant risks and rewards of ownership of the commodity are not considered to have transferred to Borrower (IAS 18), or because Reporting Entity has an obligation to repurchase substantially the same asset in 12 months' time (IFRS 15). Consequently, applying View 1, Reporting Entity accounts for the transaction with Borrower as a financing arrangement, possibly reclassifying the gold to 'inventory transferred to be received'.

View 2—Do not account for the commodity received or the commodity transferred

11. This approach is based on the view that the transactions are similar to securities lending as described in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*, which state that:

> *Repurchase agreements and securities lending—assets that are substantially the same.* If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership. ***(IAS 39 paragraph AG51(b) / IFRS 9 paragraph B3.2.16(b))***

12. According to the submitter, proponents of this view say the following:

    (a) In the absence of requirements that specifically apply, Reporting Entity applies the securities lending requirements in IAS 39 AG51(b)/IFRS 9 B3.2.16(b) by analogy as the most relevant requirements dealing with similar arrangements. This is because Reporting Entity's business model is to consider gold in the same way as it considers financial assets that are highly liquid.

    (b) In both Transaction #1 and Transaction #2, substantially all the risks and rewards of ownership of the commodity are *not* transferred. In other words, the risks and rewards of ownership of the commodity remain with Lender.

    (c) Reporting Entity does not therefore recognise the commodity received from Lender, nor an obligation to return the commodity. Instead, Reporting Entity recognises the fee payable to Lender as an expense over the contract term.

(d) Reporting Entity does not have an asset to transfer to Borrower. Applying IAS 18/IFRS 15, Reporting Entity accounts for the fee receivable from Borrower as service fee income over the contract term.

Summary of outreach conducted

13. In order to gather information about the issue described in the submission, we sent requests to the International Forum of Accounting Standard-Setters, regulators, and global accounting firms. Specifically, we asked:

Q1. Is this issue common or prevalent in your jurisdiction?

Q2. If 'yes', what is the predominant accounting treatment (assuming that neither contract includes a cash settlement option)? If possible, please describe the rationale for that approach? To what extent have you observed diversity in the accounting treatment applied?

Q3. Does the existence of a cash settlement option at maturity of the contract between Reporting Entity and Lender and/or the contract between Reporting Entity and Borrower change your response to Question 2? If possible, please describe the rationale for your response?

14. The views received represent informal opinions, rather than formal views of those responding.

Responses received—overview

15. The responses received can be summarised as follows:

	Issue is common	Issue is not common	**Total**
National standard-setters†	3	8	**11**
Accounting firms (international networks)	2	2	**4**
Accounting firms (local)	-	1	**1**
Regulators	-	2	**2**
Preparer (bank)‡	2	-	**2**
Total	**7**	**13**	**20**

†All of the national standard-setters that identified the issue as common in their jurisdiction had based their responses on information provided from large banks and accounting firms.
‡Two large banks contacted the staff directly to provide feedback.

16. All of the responses reported consistent information about the jurisdictions in which the issue is common or prevalent. Based on this information, we understand that the issue is common in Asia, Canada and South Africa. Respondents noted that all major banks in these jurisdictions enter into the type of transactions described in the submission (and other similar commodity transactions).

17. Based on the responses received, it would appear that these transactions are not common or prevalent in other jurisdictions.

18. Consequently, we think that the most useful way to summarise the information received from outreach is to segregate the information received from those respondents identifying the issue as common from information received from others.

Responses that identified the issue as common
(relevant jurisdictions: Asia; Canada; South Africa)

19. All of the respondents that identified the issue as common reported diversity in practice. The varying approaches applied generally reflect entities developing their own accounting policies applying IAS 8, in the absence of an IFRS Standard that specifically applies to the transaction. Those approaches included the following:

    (a) Applying the *Conceptual Framework* to determine whether to recognise assets and liabilities.

    (b) Analogising to the requirements in IAS 39/IFRS 9 because precious metals are readily convertible to cash. This approach generally leads to accounting similar to that described in View 2 of the submission.

    (c) Treating commodities similar to currency because they are fungible and highly liquid. This approach generally leads to accounting similar to that described in View 1 of the submission albeit that, instead of being treated as inventory, the commodity is described as a cash equivalent.

    (d) *Not* using financial instruments requirements because commodities do not meet the definition of a financial asset. In most cases, entities

applying this rationale account for the commodity transactions applying IAS 2 and IAS 18—View 1 of the submission. This approach is generally applied in the absence of other more relevant requirements, rather than because those entities think that commodity transactions are clearly captured within the scope of these IFRS Standards.

20. Some respondents also said that, in some cases, entities apply different requirements to different commodity transactions because the substance of these transactions is different. Examples of fact patterns that respondents think might appropriately lead to different accounting include the following:

    (a) The existence of a cash settlement option (rather than a requirement to return a physical commodity at maturity). In response to the specific question asked about cash settlement options:

        (i) most respondents that commented said that a cash settlement option would not change their response. This is generally because the settlement amount is based on the spot price of the commodity on the date of settlement (and thus both parties would be economically indifferent to the settlement method).

        (ii) most also said, however, that this view was limited to the specific fact pattern described in the submission. They said that, in other fact patterns, the existence of a cash settlement option could change their opinion about the accounting.

    (b) Similarly, whether any cash settlement option is based on the market value of the commodity at the settlement date, or whether it is a predetermined fixed amount of cash.

    (c) Whether any cash is exchanged at inception of a commodity transaction.

    (d) Whether a transaction similar to that described by the submitter is a single linked contract or two separate contracts. Similarly, whether the two legs of the transaction are with the same or different counterparties.

21. Many respondents also commented on the lack of requirements for commodities in IFRS Standards more generally. In their view, accounting for commodities,

and precious metals in particular, should be considered more broadly than only within the context of the scenario described by the submitter. These respondents said that considering the scenario described by the submitter in isolation may result in a 'half-informed debate' and may have unintended consequences. Examples of other questions that respondents suggested should be considered include the following:

(a) Recognition and derecognition criteria for precious metals.

(b) How to measure commodities recognised as an asset and, if relevant, how to determine their fair value.

(c) Whether the transfer (or not) of legal title should affect the accounting for commodities.

(d) Whether the accounting would differ depending on the liquidity or fungibility of the commodity. For example, some questioned whether an entity should account for gold differently from agricultural commodities.

(e) Whether the accounting would differ for a certificate of deposit of a commodity compared to the commodity itself (eg for an entity that buys and sells such a certificate without ever receiving the physical commodity).

22. Few respondents commented on whether any difference in accounting would have a material effect on entities that enter into commodity transactions. One respondent said that, although the main issue is gross (or net) reporting on the balance sheet, it can have a material effect for banks entering into these transactions. This is because the amount of assets recognised might affect a bank's capital requirements.

Responses from other jurisdictions

23. Responses relating to jurisdictions other than those listed above generally reported that there are few, if any, entities undertaking such transactions. Some of these respondents said that any relevant transactions would rarely have a material effect

on financial statements in their respective jurisdictions. Some commented that commodity loans do not exist within the relevant banking system.

24. The majority of these respondents described other commodity transactions that are more prevalent in their jurisdictions than the one described in the submission.

Staff analysis—existing requirements in IFRS Standards

25. We think that the IFRS Standards that could potentially capture the transactions are:

    (a) IFRS 16 *Leases* (or its predecessors, IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease*).

    (b) IAS 2, together with IFRS 15 (or its predecessor, IAS 18).

    (c) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

    (d) IFRS 9 (or its predecessor, IAS 39).

26. The sections below summarise our considerations as to whether the transactions described in the submission are captured by any of these Standards. For new Standards that will become effective in the near future, we have performed the analysis on the basis of the new Standard (ie the analysis refers to the requirements in IFRS 16, IFRS 15 and IFRS 9 and not those in IAS 17, IAS 18 and IAS 39). However, we then note whether our conclusions would be different applying the relevant predecessor Standards.

IFRS 16

27. We agree with the comment made in the submission (Appendix B) that the transaction does not meet the definition of a lease, and accordingly is not within the scope of IFRS 16. This is because the arrangement is not dependent on the use of an identified asset (refer to ***IFRS 16, paragraph 9***). This analysis is the same applying the requirements in IAS 17 and IFRIC 4 relating to the definition of a lease.

28. In addition, we think that the transactions described in the submission are different in substance to leases. This is because the gold to be returned at maturity in both transactions can be any bar of gold of the same quality and quantity, which is expected to be readily available in the market. Consequently, Reporting Entity (in Transaction #1) and Borrower (in Transaction #2) do not obtain only the right to use the gold for a period of time—instead, on receipt of the gold, they each have unfettered rights to sell, hold, lend, pledge or otherwise use the gold, and have an obligation to return another piece of gold (that is equivalent) in 12 months' time.

IAS 2 and IFRS 15

Relevant requirements

29. IAS 2 defines inventories as assets that are:

> (a) held for sale in the ordinary course of business;
>
> (b) in the process of production for such sale; or
>
> (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. ***(IAS 2, paragraph 6)***

Analysis

30. For Reporting Entity, the transaction described in the submission is not captured by (b) or (c) above—the commodity is neither in the process of production for sale, nor is it materials or supplies that Reporting Entity will consume in production or in rendering services.

31. The question is: does the commodity represent an asset that Reporting Entity holds for sale in the ordinary course of business (paragraph 6(a) of IAS 2)?

    (a) Reporting Entity would need to assess whether the 'buying' and 'selling' of commodities is considered to be within its 'ordinary course of business'—we think this may, or may not, be the case depending upon the particular circumstances (ie the business model of Reporting Entity).

(b) Reporting Entity would also need to assess whether the commodity is 'held for sale'. In the transaction described in the submission, Reporting Entity transfers legal title of the commodity to Borrower. However, the transaction with Borrower does not clearly represent a sale applying IFRS Standards for the reasons described in View 1(b) of the submission (Appendix B) and summarised in paragraph 10(c) of this paper.

32. For these reasons, we think that the transaction is not clearly captured by IAS 2 for Reporting Entity.

IAS 37

33. IAS 37 sets out requirements on how to account for provisions that are not within the scope of another Standard. We have considered whether the obligation to deliver gold back to Lender at the end of Transaction #1 is within the scope of IAS 37.

34. IAS 37 defines a provision as 'a liability of uncertain timing or amount'. We think that Reporting Entity's obligation to deliver gold to Lender does not meet the definition of a provision as contemplated by IAS 37. This is because the contract between Reporting Entity and Lender does not contain any uncertainty about the timing or quantity of gold to be delivered.

35. Paragraph 11 of IAS 37 addresses the question of how provisions can be distinguished from other liabilities such as trade payables and accruals. This paragraph says that trade payables are not provisions because they are liabilities that 'have been invoiced or formally agreed with the supplier'. We think that the transaction described in the submission is not a provision for similar reasons: Reporting Entity's obligation to return a specified quantity and quality of gold in 12 months' time has been formally agreed with Lender within the contractual arrangement.

IFRS 9

36. A commodity does not meet the definition of a financial asset (refer: **IAS 32 *Financial Instruments: Presentation*, paragraph 11**). This is because it is neither cash, nor a contractual right to receive/exchange cash or another financial asset.

37. In fact, the definitions section of the Implementation Guidance on IFRS 9 explicitly explains that gold is *not* a financial instrument:

> **B.1 Definition of a financial instrument: gold bullion**
> **Is gold bullion a financial instrument (like cash) or is it a commodity?**
>
> It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

38. The scope of IFRS 9 also captures particular contracts to buy or sell non-financial items as described below:

> This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. ***(IFRS 9, paragraph 2.4)***

39. We think that this paragraph does not apply to the commodity transactions described in the submission because they do not represent contracts to 'buy or sell a non-financial item'. In other words, we think that the transaction does not constitute a sale as contemplated by the financial instruments requirements. This is because the transaction described in the submission is a *lending* arrangement and, for example, applying the derecognition requirements in IFRS 9, the transferor (ie Lender in Transaction #1 and Reporting Entity in Transaction #2) would not be able to derecognise the commodity because it hasn't transferred the

risks and rewards of ownership (refer ***IFRS 9; paragraph 3.2.6(b) and B3.2.16(c)***)).

40. This analysis is the same applying the requirements in IAS 39.

Conclusion

41. In our view, the transaction in the submission is not clearly captured by existing requirements in IFRS Standards.

Staff analysis—application of IAS 8

42. In the absence of a Standard that specifically applies to a transaction, paragraph 10 of IAS 8 requires an entity to use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable (***IAS 8; paragraph 10***). IAS 8 further requires that:

> In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:
>
> (a) the requirements in IFRSs dealing with similar and related issues; and
>
> (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework (***IAS 8; paragraph 11***).

44. In order to make the judgement described in IAS 8, Reporting Entity would first assess whether any of the requirements in IFRS Standards deal with 'similar and related issues'. Reporting Entity's conclusion on which, if any, requirements deal with similar and related issues could result in different accounting outcomes. For example:

'Similar and related' issue in existing IFRS Standard	**Accounting by Reporting Entity**	**Reporting Entity recognises an asset and a liability as a result of the transaction?**
Securities lending (***IFRS 9***)	Apply View 2 described in the submission—ie account for the transaction as if the gold is not transferred from Lender to Reporting Entity.	**NO**
Revenue transaction/ transfer of inventory (***IFRS 15/ IAS 2***)	Apply approach similar to View 1 described in the submission—ie account for the purchase of gold and receipt of inventory from Lender, and a sale of gold and transfer of inventory to Borrower.	**YES**
Lease (**IFRS 16**)	Reporting Entity is the intermediate lessor in a sublease—ie recognises a lease liability owing to Lender and a lease receivable from Borrower.	**YES**
None	Analyse the transaction applying the principles in the Conceptual Framework. The staff think that Reporting Entity would conclude that it has both a liability (the obligation to deliver gold to Lender in 12 months' time) and an asset (the right to receive gold from Borrower in 12 months' time) as a result of the transaction.	**YES**

45. The term 'similar' is not defined in IFRS Standards. The staff think that whether the transaction described in the submission can be considered 'similar and related' to any transactions dealt with in the Standards listed above is a judgement that would need to be made on a case by case basis, considering the specific facts and circumstances of both the transaction and the reporting entity.

46. Furthermore, the particular issue identified by the submitter is narrow in scope. However, the responses received from outreach participants indicate that there are

other questions that arise regarding the accounting for commodities, which are potentially much broader in scope. There are commodity transactions that an entity is likely to account for differently from the commodity transaction in the submission because they are different in substance (see comments summarised in paragraph 20 of this paper).

47. For these reasons, the staff think that it would be difficult for the Interpretations Committee to reach a consensus on how to account for the particular transaction described in the submission, and also any conclusion might be of limited benefit. This is because it would provide an answer only for a narrow fact pattern, when the outreach indicates that there are many other similar (but not identical) transactions.

48. Furthermore, we think that there would be a substantial risk of unintended consequences if any narrow-scope standard setting activity were to be undertaken in this respect. In particular, unintended consequences might arise if any conclusion reached by the Interpretations Committee were to be inappropriately applied more broadly to transactions that are not the same as the transaction described.

Assessment against the Interpretations Committee's agenda criteria

49. We have assessed this issue against the agenda criteria of the current *Due Process Handbook:*

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Met.** The issue identified by the submitter does not arise in all jurisdictions. However, in those jurisdictions where it does arise, the feedback received indicates that: (a) there are diverse reporting methods applied; and (b) the issue is widespread—on the basis of feedback that the transaction is entered into by virtually all large banks in the relevant jurisdictions. Few respondents provided quantitative data about the effect of the diversity. However, on the basis of the reported diversity, the prevalence of the transactions in the affected jurisdictions, and the potential effect on capital requirements, we think that the issue could have a material effect for some banks.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Not Met.** Resolution of the diversity in practice could improve comparability of reporting between similar entities undertaking similar transactions. However, as discussed in paragraphs 46-48 of this paper, we think that any narrow-scope standard setting activity in this respect would both be difficult and carry a risk of unintended consequences that could be detrimental to financial reporting.

that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	**Not Met.** There are no existing IFRS Standards that clearly capture this transaction. Any resolution reached, therefore, would be dependent on whether the transaction is 'similar and related' to transactions contemplated in IFRS Standards and, if not, application of the *Conceptual Framework*. We do not think that the issue can be resolved efficiently for the reasons described below.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	**Not Met.** We think that addressing the risk of potential unintended consequences would make it difficult to address this issue in an efficient manner. This is because the outreach performed demonstrates that the issue is broad in scope. Fully addressing the risk of unintended consequences is therefore likely to require a substantial level of resources.
The solution developed should be effective for a reasonable time period (paragraph 5.21).	**Met.** The International Accounting Standards Board is not addressing this issue as part of any current project. Therefore any solution developed by the Interpretations Committee would be expected to be effective for a reasonable time period.

Staff recommendation

50. On the basis of the assessment against the Interpretations Committee agenda criteria, we recommend that the Interpretations Committee does not add this issue to its agenda.

51. The staff think that any response that is confined to the particular transaction described in the submission would be of limited benefit to entities and would have a high risk of unintended consequences. We think that addressing that risk of unintended consequences could not be achieved efficiently by the Interpretations Committee. Consequently, the staff think that it is not possible for the Interpretations Committee to resolve the issue efficiently within the confines of existing IFRS Standards

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation not to add this issue to its agenda?
2. Does the Interpretations Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A
Proposed wording for tentative agenda decision

We propose the following wording for the tentative agenda decision:

Accounting for commodity loans

The Interpretations Committee received a request regarding how to account for a commodity loan transaction. Specifically, the transaction is one in which one entity borrows a commodity from another entity, and then separately loans the same commodity to a third entity for the same term and for a higher fee. In each contract, the borrower obtains legal title to the commodity at inception and has an obligation to return, at the end of the contract, a commodity of the same quality and quantity as the commodity received. In exchange for the commodity loan, each borrower pays a fee to the respective lender over the term of the contract.

The Interpretations Committee was asked whether, for the term of the two contracts, the entity that borrows and then lends the commodity recognises (a) an asset representing the commodity (or the right to receive a commodity) and (b) a liability representing the obligation to deliver a commodity.

The Interpretations Committee observed that the particular transaction in the submission is not clearly captured within the scope of any IFRS Standard. In the absence of an IFRS Standard that specifically applies to the transaction, an entity applies paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy that results in information that is relevant and reliable. Paragraph 11 of IAS 8 requires an entity to consider:

(a) whether there are any requirements in other IFRS Standards dealing with similar and related issues; and, if not

(b) how to account for the transaction applying the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*.

The Interpretations Committee concluded that it would be unable to resolve the question asked efficiently within the confines of existing IFRS Standards. Any narrow-scope standard-setting activity would be of limited benefit to entities and would have a high risk

of unintended consequences. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

Appendix B
Submission

Submission to the IFRS Interpretations Committee ('IC') – accounting for commodity leases

We have observed that there are divergent views on the accounting for certain commodity transactions (commonly, but not limited to, precious metals), such as commodity leasing and commodity lending. We suggest that the IC clarify the accounting.

Commodities are fungible and can be easily replaced with similar commodities (for example the same type, same quality). Commodities are also perceived by some market participants, in particular banks, as similar to securities because they are highly liquid and can be traded in an active market. This perception gives rise to different interpretations of how the accounting literature applies to transactions involving leasing or lending of commodities.

There are often no cash inflows/outflows at the inception of commodity lease or loan and the assets received/transferred may not be the 'same' assets as those transferred/received back at the end of the arrangement.

These transactions are sometimes legally described as 'lease arrangements', but they do not meet the criteria in IAS 17/IFRIC 4 to be accounted for as a lease because fulfilment of the arrangement is not dependent on the use of a 'specific' asset or assets.

We have observed the following accounting treatments:

1) The entity 'borrowing' or 'leasing in' the commodity recognises an asset and a liability.
2) The entity 'borrowing' or 'leasing in' the commodity analogises to the guidance on securities borrowing/lending transactions in IAS 39/IFRS 9 and recognises no asset or liability.

We believe the IFRS IC should address this diversity in practice. We note that these types of commodity transactions are common and the issue is not related to a Board project that is expected to be completed in the near future.

Illustration

Bank A (reporting entity) borrows gold from Bank B for 12 months. Upon physical receipt of the gold, the legal title of the gold passes to Bank A. Bank A pays a fixed fee quarterly to Bank B, which is calculated based on the value of the gold borrowed and interest rates using the following formula:(Ounces of gold x spot price at inception) x (fixed interest rate x days outstanding). Bank A does not provide any collateral to Bank B and no cash payment occurs at inception. Bank A will deliver the same quantity and quality of gold back to Bank B at maturity. In some cases Bank A has an option to settle in cash based on the spot price on the date of settlement.

The gold spot price and interest rates used are those reported on the Reuters GOFO (Gold Forward Offer Rate) screen, and the interest rates used are those at which London Bullion Market

Association market making members will lend gold for 12 month periods, plus a credit spread reflecting Bank A's credit risk.

Bank A then lends the gold to Customer X under substantially the same terms and conditions except for a higher fee and, in some cases giving the customer the option to settle in cash at the maturity of the transaction. That is, when Customer X takes possession of the gold, it also receives legal title to the gold from Bank A. Customer X does not post any collateral and no cash payment occurs at inception. Customer X will either deliver the same quantity and quality of gold back to Bank A at maturity or (if the terms of the transaction permit) may instead choose to settle in cash based on the spot price on the date of settlement[2]. These transactions are often referred to as 'gold loans' or 'gold leases'. See the illustration below:

It is not uncommon for these agreements to be rolled over rather than the commodity to be returned at the end of the original transaction.

For purposes of this illustration, it is assumed that Bank A acts as principal (not as an agent) under IAS 18/IFRS 15.

It is also assumed that the transactions are not a leases in the scope of IAS 17/IFRIC 4, since the leased asset is not physically distinct, nor is it explicitly or implicitly identifiable, as:

- Bank A is not required to return the same physical gold to Bank B but can return gold of the same specification (same quantity and quality) to Bank B.
- the transaction does not require Customer X to return the same physical gold to Bank A, so Bank A can receive back gold of the same specification (same quantity and quality).

[2] Customer X might want to exercise a cash settlement option, for example, if it uses the gold received as part of its production process.

ACCONTING TREATMENT:

We have identified two accounting treatments applied in practice in Bank A's financial statements.

View 1 – Bank A accounts for an asset and a liability on its balance sheet

This accounting treatment is based on the view that Bank A's accounting should not be impacted by Bank B's accounting, that is, whether Bank B has recognised a sale of the gold or not. As a result, the accounting treatment applied by Bank A may or may not mirror Bank B's accounting.

a) ***Transaction #1 – Bank A borrows gold from Bank B***

Bank A accounts for the gold received as an asset. A corresponding liability is also recorded for the contractual obligation to return the gold (or cash if such an option exists) at maturity.

Those who support this view point out that Bank A has both possession of and title to the gold. The gold meets the definition of an asset in accordance with the Framework paragraph 4.4(a) because:

- Bank A controls the gold. Due to the nature of gold (highly liquid and readily convertible into cash), it is easy for Bank A to get the same quantity and quality gold in the market to return to Bank B at maturity (or to settle in cash) and hence there are no restrictions over its use of the gold.
- Bank A obtains the gold principally with the purpose of generating future profits through the higher fees. Future economic benefits will flow to Bank A when it lends out the gold during the period up to maturity.

Bank A will assess the nature of the asset to identify how to account for it under IFRS. In the fact pattern above and based on Bank A's business model, the gold asset is generally accounted for as inventory and measured at fair value less costs to sell under IAS 2.3(b).

A corresponding liability should also be recognised as Bank A has a contractual obligation to return the gold at maturity, which meets the definition of a liability in the Framework paragraph 4.4(b) and other standards. This obligation arises from the borrowing transaction and it exists no matter whether Bank A keeps the gold, lends it out or sells it.

b) ***Transaction #2 – Bank A lends gold to Customer X***

In the fact pattern above the risk and rewards of the gold are retained by Bank A (e.g. Bank A is exposed to gold price risk before and after it lends the gold to Customer X).

Under IAS 2.34, inventory is derecognised when sold. A sale is recognised when the conditions in IAS 18/IFRS 15 are met. One of the conditions in paragraph 14(a) of IAS 18 is that the entity has transferred to the buyer the significant risks and rewards of ownership. Furthermore IAS18.IE.5 requires that when goods or services are swapped for goods or services which are of a similar nature and value, the exchange should be accounted for based

on its substance and whether risk and rewards have transferred. In addition, IFRS 15.B64 and B66 provide specific guidance on transactions that include a repurchase agreement. When an entity has a repurchase obligation for a price that is greater than or equal to the original sales price, the transaction is accounted for as a financing transaction.

As a result, the gold continues to be recognised by Bank A and no revenue is recognised. The transaction is accounted for as a financing arrangement (although the gold might be reclassified to a different balance sheet line item, for example, as inventory transferred to be received, and relevant disclosures provided).

View 2 – Bank A does not recognise an asset or liability

This accounting treatment applies by analogy the accounting for stock borrowing/lending arrangements that do not involve an upfront payment. Stock borrowing/lending accounting is applied even though commodities are not financial instruments in the scope of IAS 39/IFRS 9.

This approach results in Bank A's accounting being symmetrical to Bank B's accounting (who is presumed to have retained the risks and rewards of the gold and hence did not derecognise the gold from its books) and is supported by IAS 39AG.34. However, neither Bank A's obligation to return the gold to Bank B, nor its right to receive gold from Customer X are recognised on Bank A's balance sheet.

a) Transaction #1 Bank A borrows gold from Bank B

Bank B has transferred the legal title of the gold, but it does not recognise the transaction as a sale of gold to Bank A under IAS 18/IFRS 15 for the reasons set out under section b) of View 1 above.

Bank B retains substantially all the risks and rewards of ownership of the gold, so the substance of the transaction is similar to securities lending as described in IAS 39 AG.51(b). In the absence of other guidance, this may be applied by analogy as the most relevant similar arrangements, in particular when Bank A's business model is to consider gold in the same way as it considers other liquid financial assets from a business perspective.

Bank A does not account for the gold received and, since no cash changes hands, makes no accounting entries at inception. It accounts for the predetermined fixed fee as an expense over the term of the agreement.

b) Transaction #2 Bank A lends gold to Customer X

Bank A does not have an asset on its books and therefore there is nothing to derecognise from its balance sheet. Bank A accounts for the predetermined fixed fee as a service fee over the term of the agreement in acordance with IAS 18/IFRS 15.