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IFRS Today

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VIDEO TRANSCRIPT

IFRIC agenda decisions – Three key topics from December's meeting

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"A packed agenda included three items that I think could affect many, many businesses – reverse factoring, cloud computing, and classifying debt as current or non-current."

Hello – I'm Brian O'Donovan – I'm a partner at KPMG. I'm also a member of the IFRS Interpretations Committee – the IFRIC.

I've just come out of the December Committee meeting. For me this was the most interesting, the most important Committee meeting of 2020. A packed agenda included three items that I think could affect many, many businesses – reverse factoring, cloud computing, and classifying debt as current or non-current.

Supply chain financing – reverse factoring

Reverse factoring comes in many different forms but the basic idea is that instead of you paying your supplier directly, a bank pays your supplier: you pay the bank. Lots of potential for cash flow and other benefits. Users of the financial statements are very keen to understand the extent, the nature, the impact of reverse factoring. The Committee was equally keen to provide guidance.

Let's start with your liability. Under reverse factoring, is your liability a trade payable, is it a borrowing, or is it perhaps something so distinctive it should be presented separately? And what about your cash flow – if you're paying the bank, is that an operating cash flow? Or is it a financing cashflow? And what disclosures should you consider when preparing your financial statements?

The Committee approved a final, repeat final, agenda decision on reverse factoring. It includes lots of very helpful explanatory material walking you through the requirements of existing IFRS Standards. But that's not the last we're going to hear of reverse factoring. In addition, the Board will consider potential standard setting options.

Cloud computing

Suppose you’re busy implementing a big cloud computing solution. You’ve decided that the main contract with the cloud provider will be a service contract. But what about the big up-front costs you incur to get up and running? Can you capitalise those? Or must you expense them as incurred? There’s a lot of diversity on this question at the moment.

The Committee looked specifically at two types of cost: the costs of configuring and customising the cloud software. It developed a two-part framework to help you analyse those costs. The first step would be to consider whether they qualify for capitalisation as an intangible asset. Now that could be a tough test, given that you’ve decided that the underlying cloud contract is a service contract. The second step would be to consider whether you can carry forward the costs as a prepayment of future service fees. Crucially, the Committee thinks that in making that second assessment you would look to the separation guidance – the distinct test – in IFRS 15, the revenue standard. Quite unusual, I think, to mandate that a customer should consider the revenue standard.

Now, this will be a tentative agenda decision. If you’re interested in cloud, take a look at this, see if you agree with it, see if you want to write a comment letter to the Committee.

Classification of debt as current vs non-current

The Committee looked at classification of debt as current or non-current because the IASB has introduced amendments to the classification test. These amendments are not effective yet, but let me tell you – they could be big news.

Let me give you an example. Suppose you have a December year end – you have a big loan with an important covenant that tests your financial position – perhaps it’s a working capital ratio. But this covenant is only tested in March – can that test in March affect classification in December? Well the Committee thinks that – under the new amendments – it absolutely could. The Committee believes that when you draw up your balance sheet in December, you take that covenant that is due to be tested in March and you perform a hypothetical compliance test in December using the data in your December balance sheet and that drives classification. If you have a plan that will allow you to meet the covenant in March, that doesn’t matter. If the covenant was designed to accommodate seasonality in your business, that doesn’t matter. If you fail your hypothetical compliance test in December, then your debt is current in December.

As I say, it feels like big news. Again, the Committee will publish a tentative agenda decision. Take a look at it. If you have comments, write in to the Committee: tell them what you think.

Next steps

The next step is for the Board to review the final agenda decision on reverse factoring. Only once it’s done that will the Committee issue the December IFRIC update. That will contain the official text on all the matters I’ve discussed today and some other topics as well.

Remember, if you have a fact pattern similar to one considered by the IFRIC, then you must consider the explanatory material included in final IFRIC agenda decisions when preparing financial statements under IFRS.

I think you’ll agree that this year’s December IFRIC update will be essential reading.

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