Staff paper

Agenda reference: 12A

IASB® meeting

Date	**January 2025**
Project	**Classification of Cash Flows related to Variation Margin Calls on ‘Collateralised-to-Market’ Contracts (IAS 7)**
Topic	**Finalisation of agenda decision**
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Introduction

1. At its November 2024 meeting, the IFRS Interpretations Committee (Committee) decided not to add a standard-setting project to the work plan in response to a submission about how an entity presents, in the statement of cash flows, cash payments and receipts related to variation margin calls on contracts to purchase or sell commodities at a predetermined price and at a specified time in the future. The contracts described in the submission are centrally cleared and ‘collateralised-to-market’ derivatives.

2. The purpose of this meeting is to ask the International Accounting Standards Board (IASB) members whether they object to the agenda decision, as required by paragraph 8.7 of the IFRS Foundation *Due Process Handbook*.

Background

3. The submission describes a contract (that is, a derivative) to purchase or sell commodities, used in an entity's economic activities, at a predetermined price and a specified time in the future.[1]

4. An entity may enter into such a contract for different purposes and applies the relevant requirements in IFRS Accounting Standards. For example, the entity may use such a contract:

    (a) *to receive commodities in accordance with its expected usage requirements.* The contract would be settled physically, and the entity could account for the contract by applying paragraph 2.4 of IFRS 9 *Financial Instruments* if it meets the 'own-use' exemption.[2]

    (b) *to hedge against fluctuations in the prices of commodities.* The contract would be settled net in cash. The entity would account for the contract as a hedging instrument in a cash flow hedging relationship by applying the relevant requirements in IFRS 9.

    (c) *for trading purposes.* Applying IFRS 9, the entity would classify the contract as a financial asset or a financial liability subsequently measured at fair value through profit or loss.

5. Such a contract typically has a maturity of up to three years and is both:

    (a) *centrally cleared*—after a new contract is entered into, for the purpose of settlement via a central counterparty, the contract is novated by each counterparty to the central counterparty.

[1] Appendix B to Agenda Paper 3 for the Committee's June 2024 meeting reproduces the submission.

[2] Paragraph 2.4 of IFRS 9 states: '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. …'

(b) *'collateralised-to-market'*—during the life of the contract, the counterparties make or receive daily payments based on the fluctuations of the fair value of the contract (variation margin call payments). These variation margin call payments represent a transfer of cash collateral (hence the contract is 'collateralised-to-market'), rather than a partial settlement of the contract (as in 'settled-to-market' contracts).

6. The contract can be settled physically or net in cash. At settlement, the cumulative collateral received during the life of the contract (that is, the variation margin call payments to date) is used for partial settlement of the contract. Therefore, if the contract is settled net in cash, the final payment at settlement reflects the difference between the fair value of the contract at the last variation margin call payment and the fair value of the contract at settlement.

7. The question in the submission focused only on the classification of cash flows related to variation margin call payments on the contract, and not the classification or measurement of the contract or variation margin itself, nor the presentation in the statement of financial position or statement of profit or loss.

8. Upon receiving the submission, we sent an information request on the matter to members of the International Forum of Accounting Standard Setters, securities regulators and large accounting firms. The responses to the information request indicated that the matter described in the submission was not widespread.[3]

9. On the basis of its findings, in June 2024, the Committee concluded that the matter described in the request did not meet the criteria for adding a standard-setting project to the work plan set out in paragraph 5.16 of the *Due Process Handbook*. In particular, the matter did not meet the criterion in sub-paragraph 5.16(a) that 'the matter has widespread effect and has, or is expected to have, a material effect on those affected' ('widespread and material' criterion). Consequently, the Committee decided to

[3] Paragraphs 11–23 of Agenda Paper 3 for the June 2024 Committee meeting summarise the responses to the information request.

publish a tentative agenda decision explaining its reasons for not adding a standard-setting project.

Feedback on the tentative agenda decision

10. The Committee received nine comment letters on its tentative agenda decision by the comment letter deadline.[4] Agenda Paper 4 for the Committee's November 2024 meeting summarises respondents' comments and sets out our analysis of those comments.

11. Six respondents agreed with the Committee's conclusion and tentative decision not to add a standard-setting project to the work plan. The other three respondents—comprising two individuals and a group of securities regulators—disagreed with the Committee's conclusion that the matter does not meet the 'widespread and material' criterion. In particular:

    (a) the group of securities regulators did not disagree with the Committee's tentative decision not to add a standard-setting project to the work plan but disagreed with the Committee's decision not to include explanatory material in the agenda decision. The respondent suggested providing further clarification to the tentative agenda decision.

    (b) the two individuals suggested adding a standard-setting project to the work plan.

The Committee's discussion and feedback

12. The Committee considered the feedback at its November 2024 meeting. The Committee confirmed its conclusion that the matter described in the request does not have a widespread effect and its decision not to add a standard-setting project to the work plan.

[4] At the date of posting this agenda paper, there were two late comment letters.

13. The Committee made no significant changes to the wording of the tentative agenda decision. The appendix to this paper includes the wording of the agenda decision approved by the Committee.

14. All 14 Committee members voted to finalise the agenda decision. While acknowledging the Committee's decision:

    (a) the Committee observer representing the European Commission said the IASB could consider the matter as part of its research project on the statement of cash flows and other related matters.

    (b) one of the Committee observers representing the International Organization of Securities Commissions (IOSCO) said:

        (i) similar question relating to the classification of such cash flows could arise for other types of financial instruments;

        (ii) the Committee's decision not to include explanatory material in the agenda decision could inadvertently undermine the importance of the statement of cash flows.

    In the light of his views, the Committee observer representing IOSCO said providing further guidance on the matter would be helpful.

Questions for the IASB
Do you object to the Committee's a. decision not to add a standard-setting project to the work plan? b. conclusion that the agenda decision does not add or change requirements in IFRS Accounting Standards?

Appendix—the agenda decision

A1. The agenda decision below was approved by the Committee at its November 2024 meeting.

Classification of Cash Flows related to Variation Margin Calls on ‘Collateralised-to-Market’ Contracts (IAS 7 *Statement of Cash Flows*)

The Committee received a request about how an entity presents, in its statement of cash flows, the cash flows related to variation margin call payments made on contracts to purchase or sell commodities at a predetermined price and at a specified time in the future.

Fact pattern

The request describes a contract to purchase or sell commodities at a predetermined price and at a specified time in the future. An entity may enter into such a contract for different purposes and applies the relevant requirements in IFRS Accounting Standards accordingly. For example, the entity may use such a contract:

a. to receive commodities in accordance with its expected usage requirements;

b. to hedge against fluctuations in the prices of commodities; or

c. for trading purposes.

Such a contract typically has a maturity of up to three years, can be settled physically or net in cash and is both:

a. *centrally cleared*—that is, after a new contract is entered into, for the purpose of settlement via a central counterparty, the contract is novated by each counterparty to the central counterparty.

b. *‘collateralised-to-market’*—that is, during the life of the contract, the counterparties make or receive daily payments based on the fluctuations of the fair value of the contract (variation margin call payments). These variation margin call payments represent a transfer of cash collateral (hence the contract is ‘collateralised to market’), rather than a partial settlement of the contract (as in ‘settled-to-market’ contracts).

The request asked how an entity presents, in its statement of cash flows, the cash flows related to variation margin call payments made on such a contract.

Conclusion

Evidence gathered by the Committee did not indicate that the matter described in the request is widespread. Based on its findings, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee decided not to add a standard-setting project to the work plan.