IFRS® Discussion Group

Report on the Public Meeting

December 15, 2021

The IFRS Discussion Group's purpose is to act in an advisory capacity to assist the Accounting Standards Board (AcSB) in supporting the application in Canada of IFRS® Standards. The Group maintains a public forum at which issues arising from the current application, or future application, of issued IFRS Standards are discussed and makes suggestions to the AcSB to refer particular issues to the International Accounting Standards Board (IASB) or IFRS® Interpretations Committee. In addition, the Group provides advice to the AcSB on potential changes to IFRS Standards and such discussions are generally held in private.

The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the AcSB.

The discussions of the Group do not constitute official pronouncements or authoritative guidance. This document has been prepared by the staff of the AcSB and is based on discussions during the Group's meeting.

Comments made in relation to the application of IFRS Standards do not purport to be conclusions about acceptable or unacceptable application of IFRS Standards. Only the IASB or the IFRS Interpretations Committee can make such a determination.

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ITEMS PRESENTED AND DISCUSSED AT THE DECEMBER MEETING

IFRS 9: Cash Received via Electronic Transfer as Settlement for a Financial Asset

The IFRS® Interpretations Committee (the Interpretations Committee) received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset.

In the Fact Pattern described in the submission:

- The electronic transfer system has an automated settlement process that takes three working days to settle a cash transfer. All cash transfers made via the system are therefore settled (deposited in the recipient's bank account) two working days after they are initiated by the payer.
- An entity has a trade receivable with a customer. At the entity's reporting date, the customer has initiated a cash transfer via the electronic transfer system to settle the trade receivable. The entity receives the cash in its bank account two days after the reporting date.

The request asked whether the entity could derecognize the trade receivable and recognize cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is received. The Interpretations Committee discussed this issue at its September 2021 meeting. Subsequent to the meeting, the Interpretations Committee published a tentative agenda decision on this issue.

The Group discussed the analysis included in this tentative agenda decision as summarized below.

Issue 1: Should the entity derecognize the trade receivable and recognize cash on the date the cash transfer is initiated rather than on the date the cash transfer is settled?

Analysis

Derecognition of the trade receivable

Except when an entity transfers a financial asset, paragraph 3.2.3 of IFRS 9 *Financial Instruments* requires an entity to derecognize a financial asset (trade receivable) when the contractual rights to the cash flows from the financial asset expire. Therefore, applying this paragraph to the Fact Pattern, the entity derecognizes the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire.

The Interpretations Committee noted that determining the date on which the entity's contractual rights to those cash flows expire is a legal matter, which would depend on the specific facts and circumstances; applicable laws and regulations; and the characteristics of the electronic transfer system. In the Fact Pattern, if the entity's contractual right to receive cash from the customer expires only when the cash is received, the entity would derecognize the trade receivable on the transfer settlement date.

Recognition of cash (or another financial asset)

Paragraph 3.1.1 of IFRS 9 requires an entity to recognize a financial asset "when, and only when, the entity becomes party to the contractual provisions of the instrument." In the Fact Pattern, the entity is party to the contractual provisions of an instrument- its bank account- under which it has the contractual right to obtain the cash from the bank for amounts deposited with that bank. As a result, it is only when cash is deposited in its bank account that the entity would have a right to obtain cash from the bank. Consequently, the entity would recognize cash on the transfer settlement date.

The Interpretations Committee observed that if an entity derecognizes the trade receivable prior to recognizing cash, the entity will recognize any financial asset received as settlement for the trade receivable (e.g., a right to receive cash from the customer's bank) on that same date.

The Group's Discussion

Group members agreed with the analysis.

Some Group members noted that the analysis only addresses the Fact Pattern and may not apply to other transactions involving the settlement of trade receivables. Therefore, entities need to carefully review the characteristics of their payment processing systems, the terms and conditions of the agreements with their counterparties, and the applicable laws and regulations in determining when to derecognize a trade receivable and recognize cash.

Issue 2: Practical implications of the tentative agenda decision

The Group first considered the current practice in Canada when accounting for the settlement of a financial asset via an electronic transfer and discussed whether such practice is in line with the thought process outlined in the tentative agenda decision and its conclusion.

The Group's Discussion

Several Group members observed that in practice most entities derecognize trade receivables and recognize cash when electronic transfers are settled, which aligns with the conclusion of the tentative agenda decision. In addition, one Group member observed that in practice, customers often do not notify their suppliers that the cash has been sent. Therefore, suppliers only know their accounts receivable are settled when the cash has been deposited in their bank account.

One Group member observed that most electronic transfers within North America are settled within the same business day. However, international electronic transfers sometimes take multiple days to settle. The accounting for these transactions varies in practice, depending on the terms of the agreement and the characteristics of the payment processing system in the specific jurisdiction.

The Group then discussed the following practical implications of this tentative agenda decision:

Settlement of a financial liability via an electronic transfer

Analysis

The tentative agenda decision does not address the accounting implications of a settlement of a financial liability (an account payable) via an electronic transfer.

Paragraph 3.3.1 of IFRS 9 states that “an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished - i.e. when the obligation specified in the contract is discharged or cancelled or expires.” Applying this paragraph, the customer in the Fact Pattern should assess when the financial liability should be derecognized, which is the moment the obligation is discharged.

Practical implications on other payment systems and settlement forms

Analysis

In practice, various agreements may exist between entities and their processors. The settlement mechanisms may also vary depending on factors such as the payment processor’s internal process. As a result, this tentative agenda decision can potentially have broader practical implications than the Fact Pattern the Interpretations Committee considered.

In addition, this tentative agenda decision suggests entities may need to review their approach to accounting for transactions effected via a broad range of payment systems and for more traditional forms of settlements, for example, the accounting for the issuance of cheques that have a delay of processing by a financial institution.

The Group’s Discussion

Most Group members agreed that the thought process discussed in this tentative agenda decision can also be applied to the settlement of a financial liability. However, they also identified several practical implications that entities will need to consider as part of their analysis.

Some Group members observed that the majority of entities' accounting systems are set up to derecognize accounts payable when an electronic transfer is initiated or when a cheque for payment is issued. Any payments in transit at the reporting date are tracked by the bank-reconciliation process. This process and the related controls are well established in practice. Several Group members observed that changing the way that payments in transit are accounted for could require significant changes to the bank reconciliation process and related controls.

Some Group members observed that entities might need to consider many possible factors in determining when to derecognize a financial liability. For example, an entity may need to consider whether it has the legal right to cancel a cheque or electronic payment before it is deposited in its supplier's bank account. Entities may also need to consider the terms of their supplier agreements, characteristics of their payment processing systems, and the applicable laws and regulations in the jurisdictions in which they operate. Depending on an entity’s nature and circumstances, this may require a significant effort to determine when a financial liability should be derecognized.

One Group member noted that the tentative agenda decision does not specifically address the derecognition of credit card payment receivables. However, this issue may be material, especially for retailers.

Some Group members noted that multi-day settlement periods may become rarer as technology shifts toward real-time payment settlement systems and blockchain transactions. As a result, this issue may become less significant over time.

Issue 3: Implementation of the agenda decision

Analysis

If the Interpretations Committee finalizes this tentative agenda decision, an entity should consider whether its accounting policy needs to be changed to comply with the agenda decision. Any change in accounting policy is required to be applied retrospectively using guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The entity is entitled to "sufficient time" to implement an Interpretations Committee's agenda decision. It should refer to the IASB article, "Agenda decisions – time is of the essence" and the Due Process Handbook, Sections 8.2-8.7 for guidance on the timely implementation of agenda decisions.

The Group's Discussion

Given the tentative agenda decision was not finalized in 2021, Group members agreed that entities should not be required to implement this tentative agenda decision for December 31, 2021, year-ends.

Several Group members noted that interpretation of "sufficient time" to implement this agenda decision depends on factors such as the number and the complexity of entities' settlement systems with their payment processors and individual agreements with their customers. To properly analyze the impact, entities may need to consult with their legal counsel. One Group member commented that certain sectors, such as financial institutions, may need more time to implement this agenda decision given the nature of their business.

Some Group members also highlighted the need to consider the disclosure requirements in IAS 1 *Presentation of Financial Statements* and IAS 8 when implementing this tentative agenda decision, if finalized after 2021. They noted that paragraph 122 of IAS 1 requires entities to disclose "the judgments… that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements." In addition, while paragraph 30 of IAS 8 does not specifically require entities to disclose information about changes in their accounting policies resulting from agenda decisions, similar disclosures may provide relevant information to users on the expected timing and the possible impact that applying the agenda decision will have on their financial statements.

The purpose of the Group's discussion is to highlight the analysis in the tentative agenda decision and discuss the practical implications that this tentative agenda decision can have on the accounting for entities' various payment processes. One Group member noted that the AcSB has submitted a response letter to this tentative agenda decision. The Interpretations Committee will discuss the comment letters received and decide on the next steps at a future meeting. Accordingly, the Group will monitor the outcome of this issue and may revisit this issue at another meeting. No further action was recommended to the AcSB.

Accounting for a Renewable Energy Power Purchase Agreement and the Associated Renewable Energy Credits

A renewable energy power purchase agreement (PPA) is generally defined as a contract for the purchase of power and the associated renewable energy certificates (RECs) from a renewable

energy generator (the seller) to a purchaser of renewable electricity (the buyer).[1] PPAs come in many forms, but most can be categorized as either physical or virtual.

Physical PPAs are settled by gross physical delivery[2] of electricity in exchange for periodic cash payments based on a fixed price agreed at contract inception for each unit of power delivered under the physical PPA. The fixed price is based on the prevailing forward market prices at contract inception.

Virtual PPAs (VPPAs) are periodically settled net in cash on the basis of the difference between the fixed price agreed at contract inception and a current market price on each periodic settlement date. No electricity is delivered physically.

When the renewable energy generator produces power from its renewable power facilities, it may receive a REC from a government body for each megawatt-hour (MWh) of electricity generated. RECs are market-based instruments certifying that the bearer owns one MWh of electricity generated from a renewable energy facility. RECs can be sold to others separate from the MWh produced and then resold (e.g., sold to other entities as a carbon credit to offset their own emissions).

Often the RECs generated from the renewable power facilities are included in a physical PPA or a VPPA and thus contractually required to be physically transferred to the counterparty of the physical PPA or the VPPA. The REC delivery obligation is usually indexed to a proportion of the volume of electricity in the physical PPA or the VPPA. The seller is compensated for the RECs delivered through the fixed price it receives under the contract. This means that a portion of the fixed price economically represents compensation for the RECs delivered.

The Group considered the following two fact patterns and discussed the accounting for both virtual and physical PPAs and the associated RECs.

Fact Pattern 1

- Canadian Manufacturing Co. (CMC) uses electricity in its manufacturing and processing operations in Canada.
- Renewable Power Co. (RPC) designs, builds, and operates wind and solar power generation facilities in Canada. RPC enters into various types of contracts to sell the power it expects to generate from its facilities, including physical PPAs and VPPAs. Typically, the notional amount of a physical PPA or a VPPA is based on a proportion of the volume of electricity a facility produces (e.g., 30 per cent of windfarm production).

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[1]Guide to Purchasing Green Power, United States Environmental Protection Agency, last modified September 15, 2021, https://www.epa.gov/greenpower/guide-purchasing-green-power.

[2] A contract can be subject to physical delivery in various ways, including sometimes through delivery to the customer's account. The discussion of what constitutes physical delivery is complex and outside the scope of this paper. For information on various factors, see Interpretation Committee, "IFRIC agenda decisions," *IFRIC Update*, August 2005: and the Interpretation Committee's agenda decision on Economic Benefits from Use of a Windfarm,

- When RPC produces power from its renewable power facilities, it receives a REC from a government body for each MWh of electricity generated. There is an open market for the RECs with observable prices such that RECs are considered readily convertible to cash.
- CMC enters into a VPPA with RPC. CMC makes or receives a cash payment in each settlement period equal to the difference between the fixed price per unit of power generated as defined in the VPPA and the spot price for power for 30 per cent of the output of a specific windfarm.
- As part of the VPPA, CMC will also receive RECs earned by RPC's facilities.

Issue 1: How should CMC account for the contract that includes both the VPPA and the RECs (mixed VPPA)?

View 1A– The right to receive RECs is an executory contract that qualifies for the "own use" scope exemption and the cash settled power contract is a standalone financial derivative

Proponents of this view think the rights to receive the RECs and the VPPA each represent a distinct unit of account for the following reasons:

- The rights to receive RECs and the VPPA can be transacted separately and serve different business purposes.
- The accounting for the right to receive RECs should not differ regardless of whether it is transacted separately or is bundled with a VPPA in the same contract.
- The RECs are detached from the VPPA shortly after they are generated as they are being delivered to the VPPA counterparty.

Under this view, CMC should treat the rights to receive RECs as an executory contract. The executory contract is exempt from the scope of IFRS 9 *Financial Instruments* as it meets the own use scope exemption in the standard.

Since the VPPA (apart from the RECs) is net cash settled and does not result in physical delivery of power, it does not qualify for the own use scope exemption. The VPPA meets the definition of a "derivative" in Appendix A of IFRS 9 because:

- the fair value of the VPPA changes in response to the change in the spot price of power;
- CMC is not required to make any upfront payment; and
- it is settled at a future date.

Therefore, the VPPA should be measured at fair value through profit or loss.

Opponents of this view think that:

- the mixed VPPA is one single contract. They note IFRS 9 is applied on a contract-by-contract basis. Therefore, IFRS 9 should be applied to the entire contract. In addition, they note although individual RECs are "detached" from the VPPA when they are delivered to the VPPA counterparty, the right to receive RECs over the remaining term of the VPPA is not contractually detachable from the VPPA;

- the value of the RECs is not independent from the value of the VPPA. They note that a portion of the fixed price to calculate the net settlement of the VPPA economically represents compensation for the RECs; and
- View 1A implies that an executory contract might have to be decomposed into two or more units of account when the pricing is variable and indexed to the current market price of a different item. When applying this thought process to other fact patterns, it could result in accounting outcomes that may not be appropriate.

View 1B– The mixed VPPA includes a non-financial host contract (the right to receive RECs) and an embedded price adjustment feature (the VPPA)

Proponents of this view think the mixed VPPA is a hybrid contract with the right to receive RECs as a non-financial host contract and the VPPA as the embedded derivative.

Under this view, CMC first evaluates whether the non-financial host contract meets the own use scope exemption in IFRS 9. If it does, then CMC will evaluate whether the VPPA needs to be separated from the host contract and accounted for as a derivative in accordance with paragraph 4.3.3 of IFRS 9.

Because the VPPA economically represents a net-cash settled swap on electricity prices, its economic characteristics and risks are not closely related to those of the host contract. As noted in View 1A, the VPPA meets the definition of a derivative. As a result, the VPPA is an embedded derivative that should be separated from the host contract and accounted for as a derivative.

Opponents of this view note that although RECs have become more valuable in recent years, the VPPA tends to be the economically more significant component. Therefore, it seems counterintuitive to treat the obligation to deliver RECs as the host contract.

View 1C– The mixed VPPA is a derivative contract

Proponents of this view think the rights to receive the RECs and the VPPA present a single unit of account. They think it is inappropriate to split a contract that is readily convertible into cash into one component that meets the “own use” scope exemption and another component that is accounted for under IFRS 9. Instead, the contract must be evaluated in its entirety to determine whether it meets the own use scope exemption.

Proponents of this view think if the VPPA component of the mixed VPPA is not closely related to the obligation to deliver RECs, the right to receive RECs does not qualify for the own use scope exemption. As such, the entire mixed VPPA contract does not qualify for the own use scope exemption.

Proponents of this view note that the mixed VPPA should be evaluated on the basis of its predominant characteristics. Given the VPPA component of the mixed VPPA is economically more significant and VPPA meets the definition of a derivative, the mixed VPPA should be accounted for as a derivative in its entirety.

Opponents of this view note that a separable embedded derivative should not preclude CMC from having an own use host contract. The host contract should be evaluated for embedded derivatives.

In addition, they think the predominance of the VPPA component should not dictate the accounting for the host contract.

View 1D- Accounting policy choice

Proponents of this view think the accounting guidance is not clear. Therefore, CMC has an accounting policy choice among View 1A, 1B, or 1C, to be applied consistently.

The Group's Discussion

Most Group members thought View 1B (i.e., the mixed VPPA includes a non-financial host contract and an embedded price adjustment feature) is the most technically accurate view. However, they also observed that the accounting outcomes between View 1A (i.e., right to receive RECs being a separate contract from the VPPA) and View 1B are similar. Under both views, the right to receive the RECs is accounted for as an executive contract and the VPPA is accounted for as a derivative.

One Group member noted that the differing views between View 1A and View 1B can impact CMC's analysis when designating the mixed VPPA as measured at fair value through profit or loss (FVTPL). Under View 1A, CMC should apply the guidance in paragraph 2.5 of IFRS 9 to the stand-alone contract to purchase RECs and consider whether the contract is eligible to be designated as measured at FVTPL.

Some Group members commented that whether View 1A or View 1B is more appropriate depends on the structure of the contract and the entity's business intention behind such structure. For example, when evaluating the accounting for the contract, entities should consider whether their primary business purpose to structure the contract as a mixed VPPA is to fix the price of power to be used in its operations through the VPPA as opposed to acquire the RECs.

Issue 2: If the right to receive RECs is an executory contract with an embedded VPPA derivative, how should CMC account for the RECs?

Analysis

Once received, CMC's accounting for the RECs depends on how they are used.

Per paragraph 6 of IAS 2 *Inventories*, RECs may be accounted for as inventories if they are:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.

If the RECs are not inventories, they may be accounted for as intangible assets in accordance with IAS 38 *Intangible Assets*.

The Group's Discussion

Group members agreed with the analysis.

Group members also discussed the subsequent accounting for the RECs that are intangible assets. Some Group members observed that in practice, entities that use carbon credits to offset their own emissions generally derecognize the RECs and recognize the associated expense when the RECs are cancelled. However, how and when entities cancel the RECs could impact the subsequent accounting for these credits.

Fact Pattern 2

- Similar to Fact Pattern 1, except CMC enters into a physical PPA in which it pays cash in each settlement period based on a fixed price agreed at contract inception.
- As part of the physical PPA, CMC will also receive RECs earned by RPC's facilities.

Issue 3: How should CMC account for its contract which includes both the physical PPA and the RECs (a mixed physical PPA)?

Analysis

CMC should assess whether the mixed physical PPA meets the own use scope exemption in IFRS 9.

To qualify for the own use scope exemption, the purpose of the mixed physical PPA should be for CMC to buy electricity in accordance with its expected usage requirements. If CMC has a past practice of settling similar PPAs net in cash or by taking delivery of the electricity and selling it in a short period to generate a profit from short-term fluctuations in price or dealer's margin, then the mixed physical PPA would not satisfy the own use scope exemption.

If the IFRS 9 requirements for the own use scope exemption are met, the mixed physical PPA would be accounted as a purchase of electricity and RECs. The RECs would be accounted for as either inventory or intangible assets as discussed in Issue 2 above.

The Group's Discussion

Group members agreed with the analysis.

Overall, the Group's discussion raises awareness of the accounting for both virtual and physical PPAs and the associated RECs. No further action was recommended to the AcSB.

IAS 16: Property, Plant and Equipment –Proceeds before Intended Use

In May 2020, the International Accounting Standards Board (IASB) amended IAS 16 *Property, Plant and Equipment* to prohibit an entity from deducting from the cost of property, plant and equipment (PP&E) amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, the entity will recognize such sales proceeds and related cost in profit or loss.

The amendments also clarify the meaning of the term "testing" and specify that:

- the proceeds from selling items produced while preparing PP&E for its intended use would be recognized in profit or loss in accordance with the applicable IFRS Standards. For example, IFRS 15 *Revenue from Contracts with Customers* would apply to sales of items that are assessed as being outputs of the entity's ordinary activities;

- the cost of items sold would be measured in accordance with the measurement requirements of IAS 2 *Inventories*; and
- when proceeds and costs are recognized in profit or loss for the sale of items that are not part of the entity's ordinary activities, the amounts and line items in which they are recognized should be disclosed.

These amendments are effective for annual reporting periods beginning on or after January 1, 2022. An entity shall apply these amendments retrospectively, but only to items of PP&E made available for use from the beginning of the earliest period presented when first applying the amendments.

The Group considered various issues arising from applying these amendments in practice.

Issue 1: Which industries will the amendments affect?

Analysis

While the IASB highlighted in its Basis for Conclusions that the amendments are expected to affect mining and petrochemical entities, the scope of the amendments is not limited to these industries.

The amendments will affect any industry with an item of PP&E that takes a long time to prepare for its intended use. These industries may include capital-intensive industries and industries that require a government's approval before using the PP&E. For example, automotive original equipment manufacturers need to meet regulatory requirements for safety and compatibility and might generate pre-production sales. Therefore, entities outside the extractive and petrochemical industries should also consider how these amendments affect the financial reporting.

On the other hand, entities in the extractive industry should carefully assess whether their assets are within the scope of the amendments. The amendments do not apply to costs the entity incurs in the exploration and evaluation (E&E) phase. Instead, the entity should follow IFRS 6 *Exploration for and Evaluation of Mineral Resources* to account for E&E expenditures. IFRS 6 requires E&E assets to be initially measured at cost but does not specify how an entity accounts for proceeds received during the E&E phase.

The amendments will apply to extractive entities during the development phase. Therefore, following the amendments, the entity should report the proceeds and costs from selling items in profit or loss during this phase.

The Group's Discussion

Group members agreed with the analysis.

The Group noted that, in addition to the extractive industry, the amendments may affect other capital-intensive sectors. These sectors include the semi-conductor and energy sectors, which includes wind turbines, transmission and distribution lines, hydroelectric-dams and nuclear reactors.

One Group member commented that the amendments can affect certain covenants, such as those based on earnings before interest, tax, depreciation, and amortization. Therefore, entities should assess the impact on their covenants when implementing the amendments.

Issue 2: When is an item of PP&E available for use?

Analysis

As the amendments address the accounting for proceeds and costs from selling any items produced *while preparing an item of PP&E for its intended use,* it is important to determine when an item of PP&E is available for use.

The amendment to paragraph 17(e) of IAS 16 clarified the term "testing" as "assessing whether the technical and physical performance of the asset is such that it is capable of being used in the production or supply of goods or services." While this clarification made evident that an asset that is not yet capable of production or supply of goods or services is *not* available for use, entities need to exercise judgment to determine when an asset *is* available for use.

The IASB included some indicators of when an item of PP&E is available for use in the Basis for Conclusions on the Exposure Draft "Property, Plant and Equipment— Proceeds before Intended Use". These indicators include:

(a) the physical construction of the asset is complete (as described in paragraph 23 of IAS 23 *Borrowing Costs*).

(b) the testing of the technical and physical performance of the asset is complete.

(c) the asset is capable of producing items that can be sold in the ordinary course of business (i.e. capable of producing inventories as defined in IAS 2). Consistent with the meaning of testing, this assessment would focus on the technical and physical performance of the asset, and not its financial performance.

In addition, the Group discussed the issue of what is meant by the phrase "to be capable of operating in the manner intended by management" in the context of ceasing capitalization and commencement of depreciation at its December 2014 meeting prior to the amendments to IAS 16.

Entities should provide sufficient financial statement disclosure of the significant judgments required to assess when an item of PP&E is available for use. These may include the judgments management make to distinguish when testing has been completed and when the output produced is part of ongoing production.

The Group's Discussion

Group members agreed with the analysis, noting that determining when an asset is available for use requires judgment and should be based on entity specific facts and circumstances. Some Group members observed that in the extractive industry, one area that requires judgment is whether a processing plant is ready for its intended use during a "ramp-up" period when the plant is being modified and its production is low compared to its designed capacity.

Furthermore, some Group members highlighted that the application of the amendments will be impacted by what "asset" the entity applies the amendments to, also known as the unit of account. If the entity sets the unit of account too high (i.e. groups several items or elements into the asset), the asset could have a long pre-production period. As a result, the amendments may have a greater impact on the accounting for proceeds received from selling items produced during the pre-production period.

Issue 3: How should entities allocate the costs of the items produced and sold while preparing the asset for its intended use?

Paragraph 20A of the amended IAS 16 requires entities to apply the measurement requirements of IAS 2 to the costs of items produced and sold while preparing an item of PP&E for its intended use. This new requirement can create challenges for entities in practice when allocating costs between the costs of items produced and the costs necessary to make the item of PP&E available for use.

Specifically, the Group discussed the following three challenges:

Additional judgments required

Analysis

Paragraph 12 of IAS 2 requires the costs of conversion of inventories to include both direct costs as well as a systematic allocation of fixed and variable overheads (i.e., indirect costs), including depreciation. Following the amended IAS 16, entities will need to allocate direct and indirect costs incurred during the period before an item of PP&E is available for use between the items sold and the PP&E being developed. However, the amendments do not specify any method of cost allocation. Therefore, judgment is required to determine a rational and consistent basis of allocation.

Paragraph 13 of IAS 2 requires the allocation of fixed overheads to be based on the normal capacity of the production facilities, with unallocated fixed overheads recognized as an expense when incurred. Therefore, entities need to exercise judgment to determine what "normal capacity" is when allocating fixed overheads to the items produced and sold while preparing the PP&E for its intended use. Assessing the normal capacity may be difficult when the PP&E is not yet available for its intended use in the production process.

Paragraph 16 of IAS 2 requires certain costs be excluded from the cost of inventories. For example, abnormal amounts of wasted materials, labour or other production costs should be recognized as expenses when incurred. Determining abnormal costs could be challenging in the pre-production phase.

Capabilities of the costing system

Analysis

Considering the additional costing information required as indicated in the previous section, applying the amendments may require entities to upgrade their costing system to track costs and inputs in greater detail.

The costs and efforts required to upgrade information systems could be significant.

Consumption of the PP&E

Analysis

Entities should assess whether the consumption of PP&E in producing items was more than negligible during its construction or development. More than a negligible consumption may indicate that the PP&E is available for use.

In many industries, the consumption of an item of PP&E before it is available for use is expected to be negligible. However, this may not be the case for industries where the testing period can be long and such costs could be significant.

The Group's Discussion

Group members agreed with the analysis.

In addition to the examples of costs included in the analysis, one Group member noted that borrowing costs also need to be allocated between inventories and PP&E if both meet the definition of qualifying assets.

Several Group members observed that some entities may find the process of tracking costs such as direct labour costs between the items sold and the PP&E being developed challenging and costly. One Group member thought that if these costs are not material to the entity's financial statements, the entity may consider developing a process to reasonably estimate the allocation between inventories and the PP&E instead of incurring significant costs to upgrade its financial systems.

One Group member commented that paragraph 14 of IAS 2 specifies cost allocation requirements that apply in situations with joint products. However, this paragraph suggests allocating costs based on the relative sales value of products sold. This presents challenges when allocating between inventory and PP&E since PP&E will not be sold and fair value may not be easily determinable.

Given the significant judgment required to allocate the costs of the items produced and sold while preparing the asset for its intended use, Group members highlighted the need for sufficient and transparent disclosures on the judgments that have the most significant effect on the amounts recognized in the financial statements.

Issue 4: What are some practical considerations when applying the amendments?

Analysis

When implementing the amendments to IAS 16, an entity should:

(a) identify the items of PP&E that will be impacted by the amendments and that became available for use during the earliest period that is presented when first applying the amendments;

(b) apply judgment to identify, distinguish and allocate the appropriate costs to the items produced while preparing the affected items of PP&E for intended use; and

(c) assess whether its current costing systems can track any additional cost inputs that are required for appropriate cost allocation.

Furthermore, in accordance with paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, when the entity has not applied the amendments prior to their effective date, it shall disclose:

(a) this fact; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the amendments will have on the entity's financial statements in the period of initial application.

The Group's Discussion

Group members agreed with the analysis.

Overall, the Group's discussion raises awareness of some application issues arising from the amendments to IAS 16. No further action was recommended to the AcSB.

OTHER MATTERS

Disclosure Requirements in IFRS Standards, a Pilot Approach

The IASB issued the Exposure Draft, "Disclosure Requirements in IFRS Standards, a Pilot Approach" proposing new guidance for the IASB to use when developing and drafting disclosure requirements for IFRS Standards. The IASB also proposes to replace the disclosure requirements of IFRS 13 *Fair Value Measurement* and IAS 19 *Employee Benefits* with a new set of disclosure requirements developed applying the proposed guidance.

At its July meeting, the IASB decided to extend the comment period for this Exposure Draft from October 2021 to January 2022. This extension allows more time for preparers to conduct fieldwork and provide feedback on the proposals' practical application.

The comment period deadline was January 12, 2022.

Post-implementation Review of IFRS 9—Classification and Measurement

The IASB issued the Request for Information, "Post-implementation Review of IFRS 9- Classification and Measurement". Post-implementation reviews are part of the IASB's due process and help the IASB assess the effects of requirements on financial statements users, preparers and auditors.

The comment period deadline was January 28, 2022.

Subsidiaries without Public Accountability: Disclosures

The IASB issued the Exposure Draft, "Subsidiaries without Public Accountability: Disclosures" proposing a new IFRS standard that would permit eligible subsidiaries to apply IFRS Standards with reduced disclosure requirements in their financial statements.

Canadian stakeholders are encouraged to submit their comments to the IASB by January 31, 2022.

Non-current Liabilities with Covenants (Amendments to IAS 1)

The IASB issued the Exposure Draft, "Non-current Liabilities with Covenants", aiming to improve the information companies provide about long-term debt with covenants. The proposed amendments specify that conditions with which an entity must comply within 12 months after the reporting period do not affect classification of a liability as current or non-current. Instead, entities would present separately and disclose information about non-current liabilities subject to such conditions.

Canadian stakeholders are encouraged to submit their comments to the IASB by March 21, 2022.

Supplier Finance Arrangements

The IASB issued the Exposure Draft, "Supplier Finance Arrangements" proposing amendments to IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures*. The proposed amendments include new disclosure requirements that enable financial statements users to assess the effects of the entity's supplier finance arrangements on its liabilities and cash flows.

Canadian stakeholders are encouraged to submit their comments to the IASB by March 28, 2022.

PRIVATE SESSION

The Group's mandate includes assisting the AcSB in influencing the development of IFRS Standards (e.g., advising on potential changes to IFRS Standards). The Group's discussion of these matters supports the Board in undertaking various activities to ensure Canadian perspectives are considered internationally. Since these discussions do not relate to assisting stakeholders in applying issued IFRS Standards, this portion of the Group's meeting is generally conducted in private (consistent with the Board's other advisory committees).

At its December 2021 meeting, the Group provided input on the following documents for comment to assist in the development of the AcSB's response letters:

- IASB's Request for Information- " Post-implementation Review of IFRS 9 Financial Instruments – - Classification and Measurement"
- IASB's Exposure Draft- "Non-current Liabilities with Covenants, Proposed amendments to IAS 1"