IFRS® Discussion Group

Report on the Public Meeting

May 27, 2020

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. For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips.

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 MAY MEETING

IFRS 16: Accounting for COVID-19 Related Rent Concessions

Many businesses that provide non-essential services have had to temporarily suspend their operations because of COVID-19. As a result, businesses may have received, or seek to receive, rent concessions from their landlords.

In practice, there are generally two types of rent concessions – rent deferrals and rent abatements. Rent deferrals involve the landlord agreeing to defer rent payments to a later period within the lease term. In contrast, rent abatements involve the landlord agreeing to a permanent forgiveness of specified rent payments or portions thereof.

Lessees are required to assess whether a rent concession granted due to COVID-19 is a lease modification under IFRS 16 *Leases*. If the rent concession qualifies as a lease modification, lessees would have to apply the lease modification requirements in IFRS 16, which includes a requirement to remeasure the lease liability using a revised discount rate.

In April 2020, the IASB issued Exposure Draft, "Covid-19-Related Rent Concessions", to provide lessees with relief (hereinafter referred to as "Exposure Draft"). The proposed amendments to IFRS 16 include a practical expedient that permits lessees not to assess whether certain COVID-19 related rent concessions are lease modifications. The IASB has discussed stakeholders' feedback on the proposed amendments at its May 15, 2020 supplementary IASB meeting. The IASB is expected to issue the final amendments by the end of May 2020.[1]

The Group discussed several fact patterns to highlight application considerations relating to the practical expedient based on what is expected from the final amendments to IFRS 16. The fact patterns assume that the amendments will be available for application in financial statements for reporting periods ending June 30, 2020.

At the time of this May 27, 2020 meeting, the Group has not seen the final amendments. As a result, the Group's views are based on the Exposure Draft's proposals and the IASB's discussion at the May supplementary meeting. The Group expects that the practical expedient will apply only to rent

[1] The Group's discussion took place prior to the issuance of the final amendments on May 28, 2020.

concessions occurring as a direct consequence of COVID-19, and only if all the following conditions are met:

(a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
(b) any reduction in lease payments affects only payments originally due by a specified date[2]; and
(c) there is no substantive change to other terms and conditions of the lease.

Fact Pattern 1

- A lessee has stopped making payments to its lessor in April and May 2020 because it had to temporarily close its business due to COVID-19. However, no written agreement has been reached by the lessee to obtain a rent concession from the lessor.

Issue 1: Can the lessee apply the practical expedient?

Analysis

In practice, negotiating rent concessions may take some time to accomplish. Although some lessees may not be paying their rent as it comes due, formal agreement with the landlord about alternative payment terms may not yet be reached. If a *force majeure* clause exists in the agreement, the applicability and effects of such a clause in a pandemic situation may not be certain and could take some time to determine.

Without a written agreement, the lessee cannot apply the practical expedient as a rent concession has not been agreed to by the lessee and lessor. The lessee would continue to account for the lease in accordance with the original terms because there is still a contractual obligation to make those payments, including any penalties for non-payment or late payment contemplated in the lease.

The Group's Discussion

Group members generally agreed with the above analysis, noting that there is no change to a lessee's obligation unless there is an agreement between the lessee and lessor.

Group members acknowledged that negotiating rent concessions may take some time to accomplish. Lessees may be in different stages of their negotiations, ranging from early stage to final stage pending formal sign-off. A lessee may have also reached an oral agreement with the lessor regarding rent concessions. One Group member observed there could be a situation in which a lessor provides a rent concession that is subject to the lessor obtaining a government subsidy. Concessions that are conditional on future events are discussed under Issue 5 below. Group members noted that contracts can be written, oral or implied by an entity's customary business practices, as noted in IFRS 15 *Revenue from Contracts with Customers*. Therefore, an entity would need to exercise judgment to assess whether its circumstances constitute having an agreement with the lessor to obtain rent concessions.

[2] In the final amendments to IFRS 16, the second condition states, "any reduction in lease payments affects only payments originally due on or before 30 June 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021)."

Other Group members raised additional points for a lessee to consider in its analysis. For example, if a lessee has not obtained a rent concession from the lessor, the lessee should consider whether a default under the lease agreement may trigger a breach in other agreements that may have cross-default provisions. This situation may give rise to other accounting and disclosure implications, such as potential disclosures under IAS 1 *Presentation of Financial Statements* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* An entity should also consider the need for non-adjusting subsequent event disclosures under IAS 10 *Events after the Reporting Period* if it has obtained agreement with the lessor after the reporting date.

Fact Pattern 2

- Same as fact pattern 1, except the lessee and lessor have agreed on a rent concession.

Issue 2: How does the lessee assess whether the revised consideration under the lease is "substantially the same as or less than" the original consideration for the lease before the rent concession?

Analysis

Once a rent concession is agreed to by the lessor and lessee, the lessee should determine whether the rent concession qualifies for the practical expedient. In the Exposure Draft, paragraph BC5(a) of the Basis for Conclusions states, in part, the following:

> The Board is of the view that a change that results in more than an insubstantial increase in total payments for the lease could not result solely from a covid-19-related rent concession (as described in this Exposure Draft), except to the extent the increase reflects the time value of money.

The Exposure Draft does not specify whether the lessee should use discounted or undiscounted lease payments to assess whether the rent concession qualifies for the practical expedient. Furthermore, the practical expedient is also silent on whether the assessment should be made over the remaining lease term or the entire lease term. Therefore, lessees will have to apply judgment.

The Group's Discussion

Some Group members thought that it should be apparent if a lease amendment pertains only to rent concessions occurring as a direct consequence of COVID-19, or if the lease amendment includes other changes to the terms and conditions of the arrangement. Some Group members discussed a situation when there is an increase to the revised lease consideration. In that situation, an entity would need to assess whether the increase is within the scope of the practical expedient by considering if the increase approximates a market interest rate to reflect the time value of money. A lease agreement may also change from fixed to variable rent payments. In this case, a lessee would need to determine whether the lease amendment is within the scope of the practical expedient.

Regarding whether the assessment should be made over the remaining or the entire lease term, some Group members thought that it should be based on the remaining lease term. The practical expedient is meant to cover scenarios where leases are modified as a result of COVID-19. Therefore, it seems reasonable to consider the change in payments relative to the future consideration under the leasing arrangement rather than relative to the entire leasing arrangement.

Some Group members noted that the standard is silent on whether discounted or undiscounted lease payments should be used in the assessment. Therefore, entities will need to apply judgment and that judgment should be applied consistently from transaction to transaction.

Fact Pattern 3

- A lessee and lessor have agreed to a rent deferral that results in total lease payments that are substantially the same when compared to the original lease.
- The lessee is not required to pay fixed lease payments of $100 per month in May, June and July 2020 until a later period in the lease term. For example, the lessee might be required to pay rent of $100 per month for each of October, November and December 2021, in addition to the rent normally due in those months.
- Assume that the lessee has elected to take the practical expedient in the Exposure Draft.

Issue 3: What are the implications of a rent deferral under the proposals in the Exposure Draft?

Analysis

In the Exposure Draft, paragraph BC7(b) in the Basis for Conclusions states:

> A change in lease payments that reduces payments in one period but proportionally increases payments in another does not extinguish the lessee's lease liability or change the consideration for the lease— instead, it changes only the timing of individual payments. In this case, a lessee would continue to reduce the lease liability for payments made to the lessor applying paragraph 36(b) of IFRS 16.

However, paragraph 36(a) of IFRS 16 also indicates that after the commencement date, a lessee shall measure the lease liability by increasing the carrying amount to reflect interest on the lease liability. If the lessee follows its original lease payment schedule, interest will then accrete over the months in which no lease payments are made. This creates a potential gain on settlement of the lease obligation because the interest credited to the lease liability will not be paid given the lessee would only need to make the original deferred lease payments. The accounting in such circumstances may require the exercise of judgment.

The Group's Discussion

Group members discussed the analysis above and provided several comments for consideration.

One approach is to remeasure the lease liability to reflect the revised lease payment schedule using the original discount rate and recognize the remeasurement gain in profit or loss. A few Group members discussed another approach of recording the remeasurement gain as an adjustment to the right-of use asset. This approach is similar to the remeasurement guidance in IFRS 16 for modifications, except that the adjustment is calculated using the original discount rate instead of a revised discount rate. Some Group members thought this approach seemed logical but acknowledged it could be difficult to support based on the expected wording of the amendments to IFRS 16.

Other approaches may be possible. For example, one approach may involve setting up a deferred credit that is taken into income over the term of the lease. Group members acknowledged that this is a potential application issue and discussions will likely continue after the IASB issues the final amendments. The final amendments should be assessed to see if there is wording that may help address this matter.

Fact Pattern 4

- A retailer was required to close its store in early April 2020 due to government-imposed restrictions. The retailer was supposed to pay $100 per month in rent for May, June and July 2020.
- On April 30, 2020, the landlord agreed in writing to forgive those months' rents. The forgiveness is enforceable even if the government restrictions are lifted before the end of the three-month period.
- Assume that the lessee has elected to take the practical expedient in the Exposure Draft.

Issue 4: When should the lessee recognize the forgiveness of lease payments?

Analysis

In the Exposure Draft, paragraph BC7(a) of the Basis for Conclusions states:

> A lessee applying the practical expedient would generally account for a forgiveness or waiver of lease payments as a variable lease payment applying paragraph 38 of IFRS 16. The lessee would also make a corresponding adjustment to the lease liability—in effect, derecognising the part of the lease liability that has been extinguished by the forgiveness or waiver of lease payments.

Paragraph 38(b) of IFRS 16 indicates that a lessee recognizes in profit or loss variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

The event or condition that triggered the negative variable lease payment is the agreement to forgive three months' rent on an unconditional basis. Therefore, the benefit resulting from the forgiveness of lease payments should be recognized when the agreement is reached (i.e., on April 30, 2020). This is also consistent with derecognition guidance in paragraph 3.3.1 of IFRS 9 Financial Instruments, which applies to lease liabilities.

The Group's Discussion

Group members agreed with the above analysis.

Fact Pattern 5

- Same as Fact Pattern 4, except the forgiveness of rent is conditional on a future event (i.e., the forgiveness of rent expires when the government allows the lessee's business to reopen).

Issue 5: If the forgiveness of rent is conditional on a future event, when should the lessee recognize the forgiveness of lease payments?

Analysis

It would seem appropriate to recognize the benefit resulting from the forgiveness of lease payments with each passing month that the government restriction remains in effect.

The Group's Discussion

Group members agreed with the above analysis. One Group member noted that the forgiveness period could go beyond the period covered by the practical expedient. Therefore, entities would need to assess whether such rent forgiveness would be within the scope of the practical expedient.

Fact Pattern 6

- A retailer leases a store. Due to the government-imposed restrictions, the store has been closed to the public starting early April 2020. Since that time, no online or phone orders are being fulfilled from the store. There has been no change to the lease agreement between the lessee and lessor.
- The retailer's accounting policy is to depreciate the right-of-use asset relating to the leased store on a straight-line basis over the lease term.

Issue 6: Should the lessee suspend depreciation of the right-of-use asset during the period that the lessee is prevented from using the store?

Analysis

Paragraph 31 of IFRS 16 states:

> A lessee shall apply the depreciation requirements in IAS 16 *Property, Plant and Equipment* in depreciating the right-of-use asset, subject to the requirements in paragraph 32.

Paragraph 32 of IFRS 16 indicates that a lessee depreciates the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term, unless the lease transfers ownership of the underlying asset to the lessee.

Paragraphs 31 and 32 of IFRS 16 reinforce the concept that the right to use a property under a lease is a time-based right that diminishes over time. In addition, paragraph 55 of IAS 16 indicates that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. Therefore, the lessee should continue to depreciate the right-of-use asset on a straight-line basis during the period it is unable to use the store.

The lessee should also consider whether the inability to use the leased asset is an impairment indicator. If so, it should be tested for impairment in accordance with IAS 36 Impairment of Assets.

The Group's Discussion

Group members agreed with the above analysis.

Group members noted that depreciation should not cease because the lessee has not been evicted from the premises. In a way, the lessee is still using the premises to store its goods. In addition, as

the right to use the asset is time based, consumption of the benefit inherent in the asset occurs over time and therefore depreciation of the right-of-use asset is related to the passing of time.

The Group also briefly discussed an alternative view in which an entity may want to reconsider its depreciation method in light of COVID-19 to reflect a new consumption pattern (e.g., unit of production). However, several Group members cautioned that if an entity decides to change its depreciation method, the method needs to represent a better estimate of the consumption of benefits for the remainder of the asset's useful life. As a result, it would generally represent a permanent change in depreciation method rather than a temporary change. These Group members thought it would be rare for an entity to change its depreciation method solely because of COVID-19 because the depreciation method should reflect the consumption of benefits and not the realization of benefits. They emphasized that IAS 16 has specific guidance that addresses idle assets, as noted in the analysis above.

Overall, Group members discussed these six fact patterns to raise awareness of the practical expedient in the forthcoming amendments to IFRS 16. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).

Financial Reporting Considerations of COVID-19

Many businesses are impacted by the COVID-19 pandemic. Impacts include, but are not limited to, operational impacts (including lost revenues, disrupted supply chains, unavailability of employees, and closure of facilities) and liquidity issues (collectability issues as a result of COVID-19's impact on customers, inability to raise financing, and negative impact on compliance with debt covenants). The outbreak has also resulted in significant volatility in major financial and commodities markets worldwide. This has resulted in volatility in share price for many entities. To assist individuals and businesses affected by this pandemic, the federal, provincial and other global governments have announced various support programs.

As a result of the impact of COVID-19 as noted above, there may be significant impacts to a number of financial accounting areas.

The Group discussed five potential accounting issues related to COVID-19. These issues are not exhaustive. Entities should consider their own circumstances when analyzing the financial impacts of COVID-19.

Issue 1: How does COVID-19 affect an entity's impairment assessment of non-financial assets?

Analysis

An asset or a cash generating unit (CGU) is impaired when its recoverable amount, being the higher of its fair value less costs of disposal (FVLCD) and its value in use, is less than its carrying value. Value in use is the present value of the future cash flows expected to be derived from an asset or a CGU. This present value calculation incorporates an estimate of expected future cash flows and expectations about possible variations of such cash flows. The FVLCD of an asset or a CGU reflects market participant assumptions of the fair value based on the requirements of IFRS 13 *Fair Value*

Measurement.

Entities are required to assess at each reporting period if there are indicators that an asset or a CGU may be impaired by considering both external and internal sources of information.

Assessing impairment indicators

As a result of the business disruptions caused by COVID-19, it is reasonable to expect that many businesses will identify potential impairment indicators from both internal and external sources. Entities should further analyze their own circumstances to determine whether these potential impairment indicators would result in performing an impairment test in accordance with IAS 36 *Impairment of Assets*.

When performing this assessment, an entity should consider events and information received after the reporting period only if this information provides additional evidence of conditions that existed at the end of the reporting period.

Performing impairment tests

For the value-in-use calculation, management needs to apply significant judgment in preparing forecasts and budgets when estimating the length and severity of the economic impact from COVID-19. To reflect these judgments and the uncertainty in this calculation, management may find an expected cash-flow approach based on probability-weighted scenarios to be more appropriate than a single best estimate. Significant judgment may also need to be applied in estimating the FVLCD of the asset or the CGU as the significant reduction in market transaction activities can result in fewer comparable transactions available for use in developing an estimate of fair value. Inputs other than forecasts, such as an entity's discount rate may need to be adjusted to reflect changes in the market, changes in risk, or increased uncertainty arising from COVID-19. Enhanced disclosure may be required for these key assumptions used and judgment made in estimating the recoverable amount.

Due to the increased volatility in the financial markets, market capitalization for many entities will be reduced. Some entities' market capitalization may be less than their net assets' carrying value (also known as a market cap deficiency). In such cases, these entities should consider preparing an analysis to explain the difference between the market capitalization and the recoverable amount of the assets or the CGUs. Entities that prepare interim financial statements should assess whether there are indicators of impairment for any goodwill recognized at the interim date, even though their annual test date is not during the interim period. If indicators of impairment exist, an impairment test needs to be performed. Any impairment loss recognized for goodwill at the interim period cannot be reversed at subsequent reporting dates, in accordance with IFRIC 10 *Interim Financial Reporting and Impairment*.

The Group's Discussion

Group members agreed with the above analysis.

Group members highlighted the importance of evaluating both internal and external factors when assessing whether there are indicators that assets may be impaired as the result of the COVID-19 pandemic. One Group member noted that an economic downturn, in its own right, does not automatically trigger an impairment test. This member thought that management should consider an

entity's specific circumstance, such as the forecast of mid to long term growth rates and industry performance, when identifying impairment indicators. Some Group members commented that when the carrying amount of an entity's net assets exceeds its market capitalization, management should carefully review the inputs to the value-in-use and FVLCD determinations when performing the impairment test. They also thought that management should consider qualitatively assessing the reasonability of the impairment test by reconciling the entity's market capitalization to the recoverable amount of the assets or the CGUs.

The Group noted some practical challenges in performing the value-in-use calculation. Some Group members observed that in certain situations, a significant estimate in the value in use calculation is the terminal value. They noted that management needs to ensure that maintainable earnings are used to calculate this value. One Group member commented that any change in timing of cash flows and the additional cash flows from government grants could impact the present value calculation and should be carefully analyzed.

Group members also discussed the impact of IFRIC 10 and goodwill impairment assessments in an interim period. A few Group members noted the evolving conditions of COVID-19 creates uncertainties, requiring management to exercise significant judgement when assessing the recoverability of cash generating units with significant goodwill. These judgements will need to be well supported and balanced. Therefore, they should not be overly pessimistic or optimistic. The Canadian Securities Administrators (CSA) representatives commented that individuals with governance roles should review the assumptions made by management in the impairment analysis. In addition, given the significant judgements and assumptions made in recoverability calculations, management should consider discussing these matters with their auditors when they are preparing the interim financial statements.

The Group emphasized the need for robust disclosure of assumptions and judgements made in light of the unprecedented uncertainty this pandemic is causing. A CSA representative noted that guidance was published to assist issuers when considering COVID-19's impact on their continuous disclosure requirements[3]. The CSA representative also commented that financial statement preparers should make sufficient and entity specific disclosure about the judgements made and assumptions used when preparing their financial statements. To the extent that the issuer has concluded no impairment indicators exist, the CSA will consider the issuer's continuous disclosure record holistically to determine what effect COVID-19 was expected to have on the issuer's industry and the appropriateness of the issuer's conclusion. Some Group members highlighted the need to include in the condensed interim financial statements relevant disclosures explaining significant changes in the entity's financial position and performance since the end of the last annual reporting period. For example, during an interim period, there could be an indicator that an entity's assets are impaired requiring management to test them for recoverability. Therefore, management should consider the IAS 1 *Presentation of Financial Statements* disclosure requirements related to estimation uncertainty and the specific IAS 36 disclosure requirements related to impairment

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[3] CSA/CSVM, "COVID-19: Continuous Disclosure Obligations and Considerations for Issuers," PowerPoint presentation, CSA website, March 6, 2020. https://www.securities-administrators.ca/uploadedFiles/General/pdfs/COVID-19_Continuous_Disclosure_Obligations_and_Considerations_for_Issuers.pdf

assessments when determining what information to disclose about key assumptions, estimates, and sensitivity analysis in its interim financial statements. A CSA representative reminded the Group that consideration of annual disclosure requirements in relevant IFRS standards will also be an important starting point when deciding the extent of disclosure needed for other areas impacted by COVID-19 that are initially reported in an interim period.

Issue 2: How does COVID-19 impact an entity's expected credit loss model applied to corporate trade receivables?

Analysis

The measurement of expected credit losses should reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, and the time value of money. Entities should exercise judgment and best efforts to consider all reasonable and supportable information available about past events, current conditions and forecasts of future economic conditions.

Entities using the simplified approach under *IFRS 9 Financial Instruments* to estimate lifetime expected credit losses often use provisioning matrices that are based primarily on historical collection data. Due to the impacts of COVID-19 on various industries and the economy as a whole, entities should consider adjusting the provisioning matrices to incorporate reasonable and supportable information that is available at the reporting date. These adjustments will need to reflect specific facts and circumstances and incorporate the judgments made about the pandemic's impact on a customer's industry and creditworthiness over the lifetime of the trade receivable.

Judgment may be required to apply post-model overlay assumptions that are directionally consistent with the changes in credit risk and the economic environment in measuring expected credit losses.

Previous assumptions used in the provisioning matrices regarding grouping and segmenting of counterparties with similar credit risk characteristics may no longer be appropriate as different entities may be more affected than others because of COVID-19. As such, these groupings may need to be revisited.

Entities should also disclose the key assumptions used, and judgments made in estimating the expected credit losses.

The Group's discussion

Group members agreed with the analysis, observing that due to the uncertainty from COVID-19, the assumptions about future economic conditions have become a more significant part in estimating the expected credit losses.

One Group member considered the ongoing relief programs provided by the Canadian government and noted that for the financial reporting period, entities should disclose the judgements made to distinguish the information that was known at the reporting date and used to measure the ECL from that arising in the subsequent period. In addition, for non-adjusting events, this Group member noted that entities should follow the requirements in paragraph 21 of IAS 10 to disclose the nature of the event and the estimate of its financial effect on an entity's financial statements.

A few Group members commented that customers' specific conditions must be factored into the adjustments to ECL estimates. Some Group members noted that a temporary payment relief granted to a customer is not an automatic trigger for significant increase in credit risk requiring a movement from Stage 1 to Stage 2 under the general impairment model. These Group members observed that when a model is used to estimate the ECL based on historical inputs, management should incorporate COVID-19 related factors to reflect post-model overlay assumptions in the adjustments to ECL. Some examples of these assumptions include the industry, the sector and the geographical location in which a customer operates, and the effect of government support. Another Group member observed that the impact of COVID-19 to different entities can be drastically different with some entities benefiting from the business opportunities created by the pandemic.

Fact Pattern for Issue 3

As a result of government-imposed closures due to the pandemic, many businesses have sent employees home with pay. These employees are inactive while at home but are expected to return to work whenever operations resume.

Issue 3: How should an entity account for employee costs when employees are inactive because of COVID-19?

View 3A – Salaries and wages should be accrued and expensed at the point in time that the employee becomes inactive.

Paragraphs 13(b) and 18 of IAS 19 *Employee benefits* state that when recognizing non-accumulating paid absences "an entity recognizes no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit." The triggering event is the point in time at which the employee stops providing services. At such point, the employer would estimate, accrue, and expense the amount to be paid to the employee over the course of the absence. If the amount is uncertain, an estimate should be made and subsequently updated as new information becomes available.

View 3B – Salaries and wages of the inactive employees should be accrued and expensed over time.

Under this view, wages and salaries are paid to employees to stay at home, partially to ensure a smooth transition when business returns to normal. As a result, the inactive employees are providing benefits to the employer throughout the period of inactivity.

In addition, the time of absence is continuously re-evaluated rather than fixed at the date the employee becomes inactive. Therefore, proponents of this view refer to the non-accumulating paid absences guidance in paragraphs 13(b) and 18 of IAS 19 and think that the salary continuation costs are expensed as incurred. This is consistent with the expectation that the employees will return to work when called upon to do so.

Entities should assess their own specific facts and circumstances in making the determination of how to account for such arrangements in accordance with IAS 19. There may be specific clauses within employment contracts that deal with this type of situation. Further, the plan or period of time where employees are inactive may be communicated broadly, which may create a constructive obligation.

The Group's discussion

Group members supported View 3B. Some Group members noted that the employees are not terminated. Instead, these employees are standing ready to return to work during this inactive period to ensure a smooth transition when business normalizes. Therefore, the employees' salary and wages should be accrued and expensed over time. A few Group members further highlighted some complex scenarios in practice that make it difficult to accrue and expense salaries and wages at a point in time. For example, some entities may give their employees full-time pay while the employees work reduced hours. Other entities may reduce salaries for all employees during the inactive time but reimburse the employees when business returns to normal.

Fact Pattern for Issue 4

- The Government of Canada has announced various programs to assist individuals and businesses affected by COVID-19. An example is the Canada Emergency Wage Subsidy (CEWS).
- The CEWS was announced by the Government of Canada on March 27, with further details announced on March 30, April 1 and April 8, 2020. On April 11, legislation was passed, providing more definitive clarity on the CEWS. Subject to limited exceptions, employers of all sizes and across all sectors of the economy are eligible for the CEWS, provided their revenues have decreased by 15% or more for March and 30% or more for April and May. The subsidy is calculated based on a formula that generally covers 75% of an employee's wages, to a maximum of $847 per week, retroactive from March 15, 2020.[4]

Issue 4: How does an entity account for the CEWS received, or expected to be received, as a result from COVID-19?

Analysis

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* applies to government grants. However, not all programs introduced by governments qualify as government grants in accordance with IAS 20. Paragraph 2 of IAS 20 states that the standard does not deal with:

(a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

(b) government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates.

(c) government participation in the ownership of the entity.

(d) government grants covered by IAS 41 *Agriculture*.

[4] On May 15, 2020, the Government of Canada announced that it would be extending the CEWS by an additional 12 weeks, extending eligibility, and consulting with key stakeholders on potential adjustments to the program.

In considering if the CEWS is a government grant, or if another IFRS Standard applies, an entity needs to determine who the subsidy benefits. If the subsidy benefits solely the employee, it may be viewed that the employer acts only as an agent of the government in disbursing the subsidy, and therefore, IAS 20 would not apply.

Payments made under the CEWS are designed to benefit the employer, and therefore, IAS 20 should be applied. The employer receives compensation to enable retaining its trained workforce and recommencing operations when possible. An employer is still incurring costs but can recoup an eligible amount from the subsidy program if certain revenue reduction criteria are met.

Under IAS 20, a government grant is only recognized if there is reasonable assurance that the entity will comply with the applicable conditions, and that the grant will be received.

For entities with financial reporting periods ending March 31, 2020, assessing when to recognize the government grant may be challenging. Although certain details of the subsidy were announced prior to March 31, and the subsidy is retroactive to March 15, details were not fully established until legislation was enacted on April 11. As a result, it would be difficult for an entity to establish that it qualifies for the CEWS as of March 31.

For entities with financial reporting periods ending after March 31, 2020, they will need to assess their compliance with the revenue reduction criteria as set out by the Government of Canada. If an entity can demonstrate eligibility, the grant should be recognized when the qualifying employee expense is incurred. Grant income should be presented either separately as other income or deducted from the related employee expense.

If the related employee expense is capitalized to an asset, the grant should be recognized and presented as deferred income or as a reduction from the carrying amount of the asset. The grant is then recognized into income on a systematic basis over the life of the asset.

The Group's Discussion

Group members agreed with the above analysis.

Some Group members provided practical insights into assessing the conditions to recognize government grants when applying paragraph 7 of IAS 20 to various government programs. One Group member commented that currently, many questions on the administration of the relief program remain unanswered by the government. Questions such as who is eligible for the relief program and how the various relief programs interact with each other may create uncertainties in determining whether an entity has met the grant conditions. Therefore, even though the legislation has passed for these relief programs, an entity may not be able to meet the conditions to recognize a grant until a later time. Another Group member noted that receiving the grant may not be conclusive evidence that the grant conditions have been met. Some entities may have to repay the grant in the future if they did not meet the grant conditions. This Group member also observed that for some international grants, a government's ability to provide funding may create uncertainties in determining whether the entity is reasonably assured to receive the grant if the funding is provided on a "first-come first-served" basis.

One Group member thought that there are other factors to consider in addition to who the subsidy benefits when determining whether the entity is acting as an agent of the government or not. For example, an entity should consider which party bears the responsibility to meet the grant conditions and which party would have to repay the grant and pay any penalties if the grant conditions are not met.

Fact Pattern for Issue 5

- Entity A is a manufacturer with long term contracts with customers for its products. Revenue for these contracts are recognized over time in accordance with IFRS 15 *Revenue from Contracts with Customers*.
- As a result of COVID-19, Entity A has closed its manufacturing facilities. Entity A expects that it may not be able to meet the contractual delivery deadline for the products to its customers and may have to pay penalties.
- Historically, Entity A has not estimated any payment of penalties in accounting for its long-term contracts.

Issue 5: How does COVID-19 impact the recognition of revenue?

Analysis

COVID-19 could affect an entity's revenue contracts in multiple ways. One issue to consider is the impact on the estimation of variable consideration. Variable consideration might include discounts, refunds, price concessions, performance bonuses and penalties. The amount of variable consideration an entity includes in the transaction price is constrained to the amount for which it is highly probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainties related to the variability are resolved.

In the fact pattern noted above, Entity A may need to reassess the need to account for variable consideration. This assessment will be based on its estimates and judgments about the ability to meet the contractual delivery deadline, including expected periods of closure and time to resume its manufacturing processes. Such assessment will also need to take into consideration all contractual features of the arrangement between Entity A and its customer.

Certain contracts may also contain force majeure clauses and, therefore, such clauses should be analyzed to determine if they might apply to the COVID-19 pandemic.

Other issues that an entity may need to consider include, but are not limited to, the following:

- Assessing whether the impact of COVID-19 may give rise to onerous contracts, which should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- Determining whether a contract has been modified in response to COVID-19. If both parties agree to amend the scope or price (or both) of a contract, the entity should account for the modification in accordance with paragraphs 18-21 of IFRS 15.
- Considering any changes to timing of when the performance obligations in the contract can be fulfilled, which would affect when the related revenue can be recognized.

- Reassess whether it is probable that the entity will collect the consideration to which it is entitled. Significant judgement is required to determine when an expected partial payment indicates that: (1) there is an implied price concession to be accounted for as variable consideration; (2) there is an impairment loss (to be accounted for in accordance with IFRS 9); or (3) the arrangement lacks sufficient substance to be considered a contract in accordance with IFRS 15.
- Updating disclosures for the effects of COVID-19 given IFRS 15 requires an entity to disclose information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue.

The Group's discussion

The Group agreed with the above analysis.

Group members highlighted some challenges that an entity may encounter when assessing accounting implications arising from a contract modification and reassessing the collectability of payments from customers in this COVID-19 environment. One Group member commented that entities should consider whether a modification to contract terms may include a significant financing component in the contract that the entity should account for. A few Group members noted that entities need to evaluate the collectability of contract consideration as the result of the pandemic. Significant uncertainty in collection can cause the contract to fail the definition of a contract under IFRS 15 leading to a change in the accounting outcome. Another Group member commented that interpreting whether the force majeure provision is enforceable in the COVID-19 environment can be particularly challenging, considering different interpretations of this provision by legal professionals.

One Group member encouraged financial statement preparers to review various publications available from public accounting firms to be informed of the various effects COVID-19 can have on revenue recognition accounting.

Overall, the Group's discussion on Issues 1 to 5 raised awareness of the potential impact that COVID-19 may have on an entity's financial statements. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).

IAS 1: Application of Paragraph 76B to Classify Convertible Debt as Current or Non-current

IAS 1 *Presentation of Financial Statements* contains guidance regarding the classification of liabilities as either current or non-current in an entity's financial statements. In January 2020, the International Accounting Standards Board (IASB) issued amendments to IAS 1 to clarify the criterion for classifying a liability as non-current relating to the right to defer settlement of the liability for at least 12 months after the reporting period. The IASB proposes that these amendments be effective for annual reporting periods beginning on or after January 1, 2023.[5]

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[5] The amendments were initially issued with an effective date for annual reporting periods beginning on or after January 1, 2022. However, in response to the COVID-19 pandemic, the IASB proposes to defer the effective date by one year, with earlier application permitted (see Exposure Draft, "Classification of Liabilities as Current or Non-current—Deferral of Effective Date" issued in May 2020).

The amendments introduce changes to several paragraphs in IAS 1, including paragraph 69(d) and the addition of paragraph 76B:

> 69 An entity shall classify a liability as current when:
>
> (d) it does not have ~~an unconditional~~ the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period ~~(see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification~~.
>
> 76B Terms of a liability that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying IAS 32 *Financial Instruments: Presentation*, the entity classifies the option as an equity instrument, recognising it separately from the liability as an equity component of a compound financial instrument.

Under the existing IAS 1, there is potential for diversity in practice because it is unclear whether the second sentence in paragraph 69(d) should be applied only to an equity-classified conversion feature, or whether the sentence could be applied more broadly to a conversion feature that is classified as a liability (see the Group's discussion in December 2014, "IAS 1 and IAS 32: Classification of Debt with Embedded Equity-linked Derivatives").

When the IASB issued the amendments to IAS 1, it also amended the Basis for Conclusions. Paragraph BC48H of the Basis for Conclusions states:

> The Board concluded that, when it had added the statement about counterparty conversion options in 2009, it had intended the statement to apply only to liabilities that include a counterparty conversion option that meets the definition of an equity instrument and, applying IAS 32 *Financial Instruments: Presentation*, is recognised separately from the host liability as the equity component of a compound financial instrument. The Board further concluded that, in other cases—that is, if an obligation to transfer equity instruments is classified applying IAS 32 as a liability or part of a liability—the transfer of equity instruments would constitute settlement of the liability for the purpose of classifying it as current or non-current. To reflect those conclusions, the Board moved the statement about counterparty conversion options from paragraph 69(d) to new paragraph 76B and clarified its scope.

The Group considered the application of paragraph 76B of the amended IAS 1 to the financial instruments in the following three fact patterns.

Fact Pattern 1

An entity issues a convertible bond that matures in five years after the reporting date. The bond comprises:

- a financial liability (i.e., a contractual obligation to deliver cash to the holder of the bond); and
- an equity instrument (i.e., an option granted to the holder to convert the bond into a fixed number of the entity's ordinary shares at any time before maturity).

Issue 1: Is the following analysis appropriate in determining whether paragraph 76B of the amended IAS 1 affects the classification of the convertible bond as current or non-current?

Analysis

Based on paragraph 28 of IAS 32, the convertible bond is a compound financial instrument and the two components are recognized separately. Since the conversion feature is classified as an equity instrument, the holder's option to convert the liability to equity within 12 months does not affect the classification of the liability based on paragraph 76B of amended IAS 1.

The entity has a right to defer settlement for five years given the maturity period. As a result, the entity classifies the liability component as non-current in Years 1 to 4, and as current in Year 5.

The Group's Discussion

Group members agreed with the above analysis.

Fact Pattern 2

An entity issues a financial instrument that obliges it to transfer to the counterparty a variable number of its common shares equal to CU100 at the time of transfer. The instrument is due to be settled within six months after the reporting date.

Issue 2: Is the following analysis appropriate in determining whether paragraph 76B of amended IAS 1 affects the classification of the financial instrument as current or non-current?

Analysis

The financial instrument contains a contractual obligation to deliver a variable number of the entity's own equity instruments and, therefore, the obligation is classified as a liability. As a result, paragraph 76B of amended IAS 1 affects the classification of the financial instrument as current or non-current.

The entity is required to settle the financial instrument within six months after the reporting date and, therefore, classifies the financial instrument as a current liability.

The Group's Discussion

Group members agreed with the above analysis.

Fact Pattern 3

An entity issues a foreign currency convertible bond that matures in three years after the reporting date. The bond comprises:

- a financial liability (i.e., a contractual obligation to deliver foreign currency cash to the holder of the bond); and
- an option granted to the holder to convert the bond at any time into a fixed number of the entity's common shares.

Issue 3: Is the following analysis appropriate in determining whether paragraph 76B of amended IAS 1 affects the classification of the foreign currency convertible bond as current or non-current?

Analysis

Based on paragraph 11 of IAS 32, the bond is a financial liability. The conversion option is not an equity instrument because the entity must exchange a variable amount of cash (in its functional currency) for a fixed number of its own equity instruments. This means that the conversion option fails the fixed-for-fixed condition in IAS 32. Since the conversion option is not an equity instrument, paragraph 76B of amended IAS 1 affects the classification of the convertible bond as current or non-current.

The transfer of the entity's own equity instruments is considered a form of bond settlement and the counterparty can demand such settlement at any time. As a result, the entity does not have the right at the end of the reporting period to defer settlement of the liability for at least 12 months after the reporting date. Therefore, the entity classifies the host debt liability as current in all three years.

The Group's Discussion

Group members agreed with the above analysis.

Several Group members noted that while they agree with the analysis, they observe that the accounting outcome appears counterintuitive. For example, both Fact Patterns 1 and 3 have an equity-settled option. However, the classification of the convertible bond would differ based on whether the equity-settled option is classified as an equity instrument under IAS 32. While the distinction appears artificial, they acknowledge that this is the accounting outcome produced under the amendments to IAS 1. They also noted that these amendments would result in views that differ from those expressed at the Group's December 2014 meeting when the Group discussed a hybrid contract that contains a debt host component and an embedded derivative liability.

Another Group member noted that in Canada, there are many entities that issue foreign currency convertible bonds similar to what is considered in Fact Pattern 3. These amendments will likely result in current classification of these bonds and, therefore, may affect an entity's covenant requirements.

Overall, the Group's discussion of the three fact patterns raises awareness of the amendments to IAS 1 relating to classification of liabilities as current and non-current. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).

IFRS 3 and IFRS 16: Accounting for Acquired Leases in a Business Combination

IFRS 3 *Business Combinations* provides guidance for leases acquired in a business combination. An acquirer is required to recognize right-of-use assets and lease liabilities in which the acquiree is the lessee.

Before IFRS 16 *Leases* was issued, paragraph 17 of IFRS 3 provided a classification exception. Under such exception, the classification of a lease as operating or finance in accordance with IAS 17

Leases was based on contract terms and other factors at the inception of the contract. However, there were no measurement exceptions and as such, leases were recognized at fair value.

After IFRS 16 was issued, paragraph 17 of IFRS 3 was amended to clarify that the classification exception only applies to a lease in which the acquiree is the lessor. For a lease in which the acquiree is the lessee, IFRS 3 was amended to include paragraphs 28A and 28B, which is an exception to the recognition and measurement principles in IFRS 3 for right-of-use assets and lease liabilities. The Group will discuss this recognition and measurement exception in IFRS 3.

Fact Pattern

- Entity A acquires 100 per cent of the shares in Entity S. Entity S is a lessee.
- Upon adoption of IFRS 16, Entity S elected to grandfather the assessment of whether contracts meet the definition of a lease under IAS 17 and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. Entity A had also elected to grandfather this assessment.
- Entity S has some contracts that are currently accounted for as leases because of the assessments made under IFRIC 4 that would not meet the definition of a lease under IFRS 16.
- Entity S leases a manufacturing facility in a location critical to supplying one of their customers and had concluded that it is reasonably certain of extending the renewal period for an additional five years. Entity A also has a manufacturing facility in that location with additional capacity. If Entity A were to assess Entity S's lease, it would not be reasonably certain of exercising the renewal option.
- For real estate contracts, Entity A had elected not to combine lease and non-lease components for these contracts in which it is the lessee upon adoption of IFRS 16. However, Entity S had elected to combine lease and non-lease components for leases of this class of underlying asset.

Issue 1: At the date of acquisition, does Entity A need to assess whether the contracts acquired meet the definition of a lease under IFRS 16?

View 1A – Yes, Entity A needs to assess the contracts under IFRS 16.

Paragraph 11 of IFRS 3 indicates that, at the acquisition date, an acquirer recognizes identifiable assets acquired and liabilities assumed that meet the definitions of assets and liabilities. Furthermore, paragraph 15 of IFRS 3 indicates that the acquirer classifies and designates assets acquired and liabilities assumed based on contractual terms, economic conditions, and the acquirer's own accounting policies as they exist at the acquisition date. Therefore, under this view, if a contract does not meet the definition of a lease at the date of acquisition, the contract may be accounted for as an executory contract.

Proponents of this view also consider guidance in paragraph D9 of IFRS 1 *First-time Adoption of International Financial Reporting Standards.* This paragraph indicates that a first-time adopter assesses whether a contract contains a lease based on facts and circumstances at transition date, not at contract inception date. Proponents of this view would find it inconsistent to require different accounting between the acquisition of a non-IFRS entity that is adopting IFRS Standards and the acquisition of an entity that already reports under IFRS Standards.

View 1B – No, Entity A can retain the Entity S's assessment (i.e., rely on the assessment under IAS 17 and IFRIC 4 that has been grandfathered into Entity S's financial statements under IFRS 16)

Proponents of this view think that Entity A would not be permitted to reconsider whether the contract is a lease absent a modification to the contract on acquisition. By retaining the acquiree's assessment of whether a contract is a lease, Entity A is recognizing the existing identifiable assets and liabilities of the acquiree as required by paragraph 10 of IFRS 3.

View 1C – There is an accounting policy choice.

Proponents of this view think that IFRS Standards have no explicit guidance and therefore, Views 1A or 1B are considered appropriate and should be applied consistently.

The Group's Discussion

Group members agreed with View 1A. They thought the guidance in paragraph 28B of IFRS 3 is clear that the acquirer shall treat acquired leases as a new lease at the acquisition date in accordance with IFRS 16.

While supporting View 1A, Group members highlighted several practical challenges that the acquirer faces when assessing lease contracts in a business combination. Some Group members observed that it is often challenging for the acquirer to finish the process of reassessing the acquiree's contracts for potential leases during the reporting period in which the acquisition is completed. This is especially the case when the acquirer is unfamiliar with the acquiree's business or when the information is not immediately available to the acquirer to make proper assessments.

A representative from the Canadian Securities Administrators commented that the time constraint is even greater when the acquirer is preparing pro-forma financial statements in a prospectus. It may be challenging for the acquirer to complete the required lease assessment for all the acquiree's contracts in such a short time frame. Considering this constraint, the acquirer should disclose in the pro-forma financial statements the key assumptions made for the lease assessments and the calculation of the right-of-use assets and lease liabilities. Such information can be valuable for financial statement users.

A few Group members acknowledged that the one-year measurement period can provide some relief for the acquirer. However, they thought that the practical challenges the Group noted may still remain when considering the additional time required to implement IFRS 16 to new leases identified.

One Group member commented on the additional rationale provided for View 1A being an analogy to IFRS 1. This Group member believed that such an analogy is not appropriate because IFRS 1 is used when an entity is first adopting the IFRS framework, which is different from paragraph 28B of IFRS 3 which provides an exception to the measurement principles of IFRS 3.

Issue 2: When Entity A recognizes the acquired manufacturing plant lease for which it is a lessee, should the lease term established by Entity S be used, or should Entity A reassess the lease term?

View 2A – Entity A should reassess the lease term based on its own perspective.

Paragraph 28B of IFRS 3 states, in part, that "the acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in IFRS 16) as if the acquired lease were a new lease at the acquisition date."

Based on this paragraph, proponents of this view think that the acquirer (i.e., Entity A) should determine what is the appropriate term of the lease to which it has become a party. Entity A acquired a new lease as a result of the acquisition. Accordingly, the lease term should be reassessed from the acquirer's perspective.

Proponents of this view also think that a market participant's view is not relevant (i.e., View 2B) because the lease term is determined using the principles in IFRS 16. This determination is based on an entity's own assessment of whether the lease is reasonably certain to renew. This is different from determining the fair value adjustment for the lease, because the fair value would be determined from a market participant's perspective.

View 2B – Entity A should reassess the lease term but using a market participant's perspective.

This view is similar to View 2A, except that the reassessment is based on a market participant's assessment of the lease term. The general principle in IFRS 3 requires the acquirer to measure identifiable assets acquired and liabilities assumed using fair value that is based on a market participant's perspective.

Furthermore, paragraph B43 of IFRS 3 provides application guidance addressing assets that the acquirer intends not to use or to use in a way that is different from the way other market participants would use them. Therefore, proponents of this view think that the lease term should be reassessed using a market participant's perspective.

View 2C – Entity A should use the lease term established by Entity S.

Paragraph 28B of IFRS 3 deals specifically with the measurement of lease payments. However, the paragraph is silent on whether these payments are determined based on the acquiree's or acquirer's assessment.

Proponents of this view think that if the standard intended for the lease term to be reassessed, paragraphs 28A and 28B of IFRS 3 would have specified as such. Furthermore, under IFRS 16, no event has occurred that would permit the lessee in the contract to reassess the lease term. Therefore, they think that the acquiree's assessment of the lease term should be used.

View 2D – There is an accounting policy choice.

Proponents of this view think that IFRS Standards have no explicit guidance and therefore, Views 2A, 2B or 2C are considered appropriate and should be applied consistently.

The Group's Discussion

Group members agreed with View 2A for the reasons described in the analysis above.

Issue 3: For real estate leases in which Entity S is the lessee, does Entity A need to separate the lease and non-lease components upon acquisition to be consistent with its own accounting policy?

View 3A – Yes, Entity A needs to allocate the consideration between the lease and non-lease component to align with its own accounting policy.

Proponents of this view think that to apply IFRS Standards appropriately after the acquisition, Entity A must identify contracts that Entity S has elected to combine the lease and non-lease components. It will need to apply its own accounting policy and separate the lease and non-lease components from the identified contracts using stand-alone prices at the date of acquisition. As a result, Entity A accounts for similar contracts in a consistent manner within its financial statements in accordance with its own accounting policy.

View 3B – No, Entity A can retain Entity S's allocation of the consideration because there is no requirement to align the acquiree's accounting policy with the acquirer's accounting policy.

Proponents of this view think that the acquiree's accounting policy is left unchanged and the right-of-use asset is adjusted to reflect favourable or unfavourable terms of the lease from a market participant's perspective.

Under this view, IFRS 3 ensures that market values for the consideration paid are reflected in the assets acquired and liabilities assumed. This can be achieved without reallocating the consideration between the lease and non-lease components of the contract.

View 3C – There is an accounting policy choice.

Proponents of this view think that IFRS Standards have no explicit guidance and therefore, Views 3A or 3B are considered appropriate and should be applied consistently.

The Group's Discussion

Group members agreed with View 3A for the reasons described in the analysis above.

Issue 4: For lease contracts in which both Entity A and Entity S have elected to separate the lease and non-lease components, does Entity A need to revisit the allocation of consideration between the components at the date of acquisition?

View 4A – Yes, Entity A needs to assess the allocation under IFRS 16 at the date of acquisition.

Under this view, the acquirer analyzes what a market participant would pay for the contract and determines if the appropriate cash flows are allocated to the assets that the acquirer recognizes. Although market adjustments would be captured in the assets recognized, the effect on profit or loss will differ if cash flows are reallocated between lease and non-lease components. To apply other IFRS Standards appropriately after acquisition as required by paragraph 15 of IFRS 3, proponents of this view think that the remaining consideration should be appropriately allocated based on stand-alone prices at the date of acquisition.

View 4B – No, Entity A can retain the previous allocation as determined by Entity S.

Proponents of this view think that the acquiree's accounting policy is left unchanged and the right-of-use asset is adjusted to reflect favourable or unfavourable terms of the lease from a market participant's perspective. IFRS 3 has no requirement to revisit the original allocation of consideration to different components of the contract.

The Group's Discussion

Group members agreed with View 4A for the reasons described in the analysis above. One Group member highlighted the importance of revisiting the allocation between lease and non-lease components as this allocation can impact common performance measures such as earnings before interest, taxes, depreciation and amortization. One Group member observed that when the accounting of the acquiree's lease contract differs between the acquirer and the acquiree, the acquirer will need to adjust the amounts reported by the acquiree during consolidation. Depending on the terms of the lease, these consolidation adjustments could exist for many years. Several Group members thought this problem may be resolved if push-down accounting were permitted under IFRS Standards. Furthermore, the Group members observed that these types of consolidation adjustments are common for acquirers following business combinations. Several Group members therefore recommended the AcSB suggest the topic of push-down accounting be considered by the IASB as part of its 2020 Agenda Consultation.

(For a full understanding of the discussions and views expressed, listen to the audio clip)

IFRS 3 and IFRS 16: Accounting for Acquired Leases in an Asset Acquisition

IFRS 3 *Business Combinations* provides guidance for leases acquired in a business combination. An acquirer is required to recognize right-of-use (ROU) assets and lease liabilities in which the acquiree is the lessee. The acquirer is required to measure the lease liability at the present value of the remaining lease payments as if the lease were a new lease at the acquisition. The ROU asset is measured at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market returns.

However, IFRS 3 excludes from its scope an acquisition of an asset or a group of assets that does not constitute a business. Paragraph 2(b) of IFRS 3 states, in part, that:

> the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in IAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.

The Group discussed how an acquirer should account for acquired leases in an asset acquisition.

Fact Pattern

- On January 1, 2020, Entity A acquires 100 per cent of the shares in Entity B in exchange for cash. Entity B leases a building. The transaction does not qualify as a business combination under IFRS 3 and, therefore, is an asset acquisition.

- Entity B entered into the lease agreement on January 1, 2018. Under the lease terms, Entity B agreed to lease the building for a non-cancellable five-year term in exchange for fixed monthly lease payments. The lease has a renewal option for an additional three years, at fixed prices as stipulated in the lease. At the lease commencement date, Entity B determined that it is not reasonably certain it will exercise the renewal option and concluded the lease term is five years.
- At the acquisition date, Entity A (acquirer) determines that the agreement for the rental of the building meets the definition of a lease in accordance with IFRS 16 Leases. Entity A also assesses that it is reasonably certain to exercise the renewal option.

Issue 1: How should the acquirer measure the ROU asset and lease liability at the acquisition date of January 1, 2020?

View 1A – Measure the ROU asset and lease liability on a relative fair value basis.

Proponents of this view consider that the ROU asset and lease liability should be measured on a relative fair value basis in accordance with paragraph 2(b) of IFRS 3.

The fair value of the lease liability would reflect market participant assumptions, which may differ from those of the acquirer. As a result, the lease liability and the corresponding ROU asset may not be the same as the amounts determined under IFRS 16 at the date of acquisition.

View 1B – Measure the ROU asset and lease liability by applying IFRS 3 and IFRS 16.

Under this view, guidance in IFRS 3 for leases acquired in a business combination and in IFRS 16 is considered more appropriate in accounting for leases acquired in an asset acquisition because the standard provides an exception to the general recognition and measurement principle in IFRS 3 for leases acquired in a business combination.

Proponents of this view look toward the IFRS Interpretations Committee's November 2017 agenda decision on "Acquisition of a Group of Assets." The agenda decision outlines two possible approaches when the purchase cost is different from the sum of the fair values of the identifiable assets and liabilities acquired. Under both approaches, when an asset or liability is measured under the relevant IFRS Standard at an amount other than cost, it is measured at such amount and not at its relative fair value. For example, a financial instrument is initially measured at fair value under IFRS 9 *Financial Instruments* and not its relative fair value in an asset acquisition.

Proponents of this view note that IFRS 16 does not use cost as a measurement basis, but rather requires the lease liability to be measured at the present value of the lease payments over the lease term. Although the ROU asset is measured at cost in accordance with paragraph 23 of IFRS 16, the starting point in measuring the asset is based on the initial measurement of the lease liability. As a result, proponents of this view think that the ROU asset and lease liability are measured at an amount other than cost and, therefore, should be measured in accordance with IFRS 3 and IFRS 16.

View 1C – Measure the lease liability by applying IFRS 3 and IFRS 16 and measure the ROU asset on a relative fair value basis.

This view is similar to View 1B, except that since the measurement basis of the ROU asset is at cost based on paragraph 23 of IFRS 16, paragraph 2(b) of IFRS 3 would apply such that the cost of the ROU asset is measured using a relative fair value basis at the date of purchase.

The Group's Discussion

Group members thought that all three views presented have some merit given the lack of specific guidance in IFRS 3 regarding the measurement of ROU assets and lease liabilities for asset acquisitions.

Some Group members preferred View 1B and the second approach outlined in the November 2017 IFRIC Agenda Decision. Under that approach, the entity would initially measure the ROU asset and the lease liability applying IFRS 3 and IFRS 16. The entity then deducts these amounts from the transaction price of the asset group and allocates the residual transaction price to the remaining identifiable assets and liabilities based on their relative fair values at the date of the acquisition. These Group members thought the measurement of the ROU asset and lease liability using this approach aligns with IFRS 16 and thus more intuitive. One Group member observed that under View 1A, the relative fair value approach uses market participant assumptions that could differ from those of the acquirer, resulting in a lease liability and the ROU asset that do not reflect the cash payments the acquirer is obligated to make under the lease. Another Group member thought that the lease liability measured using the cash payments required under the lease provides more relevant information to financial statement users. This Group member also thought that measurement of the corresponding ROU asset should reflect the value of the asset acquired.

One Group member commented that the acquirer should disclose in the financial statements which approach they have used, given that the measurement of these assets and liabilities could differ significantly dependent on which approach is applied.

Issue 2: Assuming View 1A in Issue 1 applies, is the acquirer required to make an adjustment to the ROU asset and lease liability to comply with the measurement principles in IFRS 3 and IFRS 16 immediately after the acquisition date?

One potential view is that if an adjustment is required after the acquisition date, it seems to contradict the purpose of paragraph 2(b) of IFRS 3. This paragraph is intended to measure identifiable assets and liabilities based on their relative fair values at the date of purchase. Therefore, the relative fair value amount can be viewed as the starting point or "deemed cost" for purposes of applying IFRS 16 for the ROU asset and lease liability such that after the acquisition date, no adjustment to amount initially recognized is required.

The Group's Discussion

Several Group members commented that this issue highlights various complex challenges when applying View 1A in Issue 1, as opposed to View 1B and the second approach outlined in the November 2017 IFRIC Agenda Decision. To illustrate, one Group member contemplated a scenario where a market participant would assume the lease will be renewed, which may differ from the acquirer's assumption. Under the relative fair value approach, the entity will incorporate the market participants' assumption and include the renewal period in the lease term. As a result, the initial measurements of the lease liability and the ROU asset can be considerably larger than those under IFRS 16. This Group member observed that this difference in measurement can cause complexity in the acquirer's subsequent measurement of the ROU asset and the lease liability following IFRS 16.

Issue 3: Assuming Views 1B or 1C in Issue 1 applies, is the acquirer required to reassess the assumptions used to measure the lease liability at the acquisition date based on the requirements in IFRS 16?

One potential view is to reassess the assumptions based on considering the requirements in paragraph 28B in IFRS 3 for leases acquired in a business combination. This paragraph states, in part, that "the acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in IFRS 16) as if the acquired lease were a new lease at the acquisition date." Proponents of this view think that this paragraph suggests an acquired lease should be treated as a new lease at the acquisition date and, therefore, the acquirer would need to reassess the assumptions, as well as the lease term, to measure the lease liability and ROU asset.

The Group's Discussion

Group members agreed with the above analysis.

Overall, Group members observed that the new definition of a business in IFRS 3 may result in more acquisitions being classified as asset acquisitions. Given the lack of guidance on asset acquisitions in IFRS 3, Group members thought some standard setting on asset acquisition accounting may be necessary. Therefore, the Group recommended that the AcSB consider suggesting that this topic be considered by the IASB as part of its 2020 Agenda Consultation or referring to the IFRS Interpretations Committee as a follow up to the November 2017 Agenda Decision.

(For a full understanding of the discussions and views expressed, listen to the audio clip).

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IFRS 3, IAS 12, and IFRIC 23: Uncertain Tax Position Acquired in a Business Combination

At the June 2019 IDG meeting, the Group recommended that the AcSB consider referring the issue of whether the exception described in paragraph 24 of IFRS 3 could be revised to include both current and deferred tax assets or liabilities to the IASB or the IFRS Interpretations Committee.

At the December 2019 IASB meeting, the IASB tentatively decided not to add an exception to its recognition principle for current assets and liabilities within the scope of IFRIC 23. Staff will continue monitoring future developments in this area.

IFRS 16: Sale-leaseback Transaction with Variable Payments

At its September 2019 meeting, the Group recommended that the AcSB consider referring the issue of how to measure and present the liability related to fixed and variable lease payments in the financial statements to the IFRS Interpretations Committee.

Following the meeting, the IFRS Interpretations Committee received a submission of a similar fact pattern and discussed this issue at its March 2020 meeting. The Committee has tentatively decided that the seller-lessee should recognize a lease liability[6] at the date of the transaction, even if all the

[6] At its June 16, 2020 meeting, the IFRS Interpretations Committee decided to remove the reference to "lease" from the description of the liability in the final agenda decision.

payments for the leases are variable and do not depend on an index or rate. The Committee recommended the IASB amend IFRS 16 to specify how the seller-lessee applies IFRS 16's subsequent measurement requirements to the lease liability that arises in the sale and leaseback transaction.

The IASB subsequently discussed this matter at its April and May 2020 meetings. The IASB has decided to propose a narrow-scope amendment to IFRS 16, specifying how a seller-lessee should apply the subsequent measurement requirements in IFRS 16 to the lease liability that arises in the sale and leaseback transaction. The IASB plans to publish the exposure draft in the third quarter of 2020.

Staff will continue monitoring future developments on this topic.

IFRS 16 and IAS 37: Variable Lease Payments and Onerous Lease Provisions

At its September 2019 meeting, the Group recommended that the AcSB consider referring the issue of whether an onerous provision should be recognized for any variable payments not recognized in the lease liability either to the IASB or the IFRS Interpretations Committee.

The AcSB discussed this issue at its March meeting and will continue monitoring this issue to determine whether further action is warranted.

OTHER MATTERS

Reminders on IASB® Documents for Comments

General Presentation and Disclosures (Primary Financial Statements)

In December 2019, the IASB published its Exposure Draft, "General Presentation and Disclosures (Primary Financial Statements)," with comments due September 30, 2020. The IASB proposed new requirements for presentation and disclosure in financial statements, focusing on the statement of profit or loss. The proposals would result in a new IFRS Standard that sets out general presentation and disclosure requirements relevant to all companies, replacing IAS 1 *Presentation of Financial Statements*.

Classification of Liabilities as Current or Non-current – Deferral of Effective Date (Amendment to IAS 1)

In January 2020, the IASB issued narrow-scope amendments to IAS 1 *Presentation of Financial Statements* to clarify how to classify debt and other liabilities as either current or non-current. The original effective date of the amendments was January 1, 2022. However, due to the COVID-19 pandemic, the IASB has published an exposure draft to propose a deferral of the effective date by one year. The deadline to comment on this exposure draft was June 3, 2020.

Business Combinations- Disclosures, Goodwill and Impairment

In March 2020, the IASB published the Discussion Paper, "Business Combinations—Disclosures, Goodwill and Impairment" with comments due December 31, 2020. The Discussion Paper sets out the IASB's preliminary views on how companies can provide better information so that investors can more effectively hold companies to account for their decisions to acquire other businesses. The preliminary views focus on disclosure of information and on accounting for goodwill, including some simplifications for impairment testing.

(For opening remarks and updates, including other matters, listen to the audio clip.)

PRIVATE SESSION

The Group's mandate includes assisting the AcSB in influencing the development of IFRS Standards (e.g., providing advice on potential changes to IFRS Standards). The Group's discussion of these matters supports the AcSB in undertaking various activities to ensure the 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 AcSB's other advisory committees).

Documents for Comment

At its April 2020 meeting, the Group provided input on the following documents to assist in the development of the AcSB's response letters:

- IASB Exposure Draft, "General Presentation and Disclosures (Primary Financial Statements)"; and
- IASB Exposure Draft, "Interest Rate Benchmark Reform—Phase 2: Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16".
- Canadian Securities Administrators document, "Revised Version of Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure".