IFRS® Discussion Group

Report on the Public Meeting

January 10, 2018

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 JANUARY MEETING

Cryptocurrencies

The focus of the Group's discussion was on the accounting for investments in decentralized digital currencies (also referred to as cryptocurrencies). There are many different types of cryptocurrencies in the market (www.coinmarketcap.com). The terms and conditions of each type of cryptocurrency should be considered to determine the appropriate accounting.

In general, cryptocurrencies are a medium of exchange but differ from other currencies in that they only exist in virtual form. Similar to fiat currency, a cryptocurrency is not backed by any physical commodity. However, unlike fiat currency, it is not backed by a central bank, government or other entity, nor is it considered legal tender in Canada. As such, digital currency transactions are undertaken on a decentralized, peer-to-peer network. The peers in this network are the people that take part in digital currency transactions, and their computers make up the network. There is no middle party facilitating these transactions.

Issue 1: Is a cryptocurrency an asset?

In the existing *Conceptual Framework for Financial Reporting (Conceptual Framework)* issued by the IASB in September 2010*,* paragraph 4.4(a) defines an asset as follows:

> "An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity."

The existing *Conceptual Framework* notes that the future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The definition embraces items that are not recognized as assets because they do not satisfy the recognition criteria. For example, the expectation for future economic benefits must be sufficiently certain to meet the probability criterion before an asset or liability is recognized.

View 1A – Yes, a cryptocurrency is an asset

Paragraph 4.11 of the existing *Conceptual Framework* states, in part, that "physical form is not essential to the existence of an asset." Paragraph 4.12 of the existing *Conceptual Framework* further states, in part, that "although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control."

Proponents of this view note that investors control their investments in a cryptocurrency as they control its use through the mechanics of the public distributed ledger.

View 1B – No, a cryptocurrency is not an asset.

Proponents of this view consider the uncertainty around whether future economic benefits are expected to flow from a cryptocurrency to the entity to be sufficiently high that an asset does not exist.

The Group's Discussion

Group members agreed that a cryptocurrency is an asset (View 1A).

Issue 2: Assuming a cryptocurrency is an asset, what is the appropriate accounting model to apply?

There are various accounting models being considered for cryptocurrencies, each with differing views. Below are the discussion points relating to each accounting model. As mentioned earlier, it is important to note that the terms and conditions of each type of cryptocurrency should be considered to determine the appropriate accounting.

Hierarchy of Generally Accepted Accounting Principles (GAAP Heirarchy)

View 2A – The GAAP Hierarchy permits an entity to apply judgment in developing and applying an accounting policy.

In the absence of an IFRS Standard that specifically applies to a transaction, other event or condition, management should apply the GAAP Hierarchy described in paragraphs 10 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

Management should apply its judgment in developing and applying an accounting policy that results in information that is relevant and reliable. The financial statements should represent faithfully the financial position, financial performance and cash flows of the entity. They should also reflect the economic substance of transactions, other events and conditions, and not merely the legal form.

View 2B – The GAAP Hierarchy prohibits analogizing to other IFRS standards or applying judgment in determining an appropriate accounting policy (i.e., an entity needs to first consider the requirements in IFRS Standards dealing with similar or related issues).

Paragraph 11 of IAS 8 states the following:

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

Proponents of this view think that in applying paragraph 11 of IAS 8, an entity is directed to consider the requirements in IAS 38 *Intangible Assets*. A cryptocurrency has no physical substance and the accounting principles in IAS 38 deal with an identifiable non-monetary asset without physical substance.

Intangible asset

View 2C – A cryptocurrency is an intangible asset.

Proponents of this view think that either IAS 38 applies, or that that the GAAP Hierarchy directs an entity to IAS 38 as it provides sufficiently reliable and relevant accounting for a cryptocurrency given the asset is without physical substance. The asset is non-monetary because either (1) it is not a fiat currency and/or (2) it is not an asset to be received in a fixed or determinable number of units of currency in that it cannot be settled for a fiat currency. A currency is intended to encompass fiat currencies (i.e., those that are legal tenders).

View 2D – A cryptocurrency is not an intangible asset.

Proponents of this view think that IAS 38 does not apply because although a cryptocurrency has no physical substance, the accounting result of applying IAS 38 is not relevant. If IAS 38 was applied, a cryptocurrency would be carried at either cost or at its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses (i.e., the revaluation method). Under the revaluation method, only impairment losses are recognized in profit or loss. Gains are generally recognized in other comprehensive income.

In addition, IAS 38 only permits intangible assets to be revalued if there is an active market with sufficient frequency and transaction volume that takes place to provide pricing information on an ongoing basis. There are various exchanges through which cryptocurrency transactions are effected. However, the transaction values can be so volatile that a reliable value cannot be ascertained.

As a result, proponents think the more relevant measurement method is fair value through profit or loss given the nature of a cryptocurrency.

Financial asset

View 2E – A cryptocurrency is a financial asset.

Proponents of this view look to the definition of a financial asset in paragraph 11 of IAS 32 *Financial Instruments: Presentation*. They think that a cryptocurrency is virtual cash in that it is a medium of exchange that enables investors to purchase goods or services. Although a cryptocurrency is not a fiat currency and there is no one party standing ready to convert the investment into a fiat currency, these factors are not considered determinative.

View 2F – A cryptocurrency is not a financial asset.

Proponents of this view look to the definition of cash in paragraph 6 of IAS 7 *Statement of Cash Flows* to determine if cryptocurrencies are considered cash. Cash has the following meaning: "*Cash* comprises cash on hand and demand deposits."

Proponents of this view note that an investor of a cryptocurrency is not able to demand its cash back. The investor is only able to monetize its investment by either selling its cryptocurrency to another investor or by using it to purchase goods or services. Further, it is not cash on hand in the traditional sense. Other than for the impact of inflation, cash maintains its purchasing power. A cryptocurrency's value can be too volatile to be considered cash or analogous to cash.

To be a non-cash financial asset, an investor must have a contractual right to cash, or other assets, or a contract to be settled in equity instruments of an issuer. Proponents of this view note that a cryptocurrency is not an equity instrument of another party (i.e., it is not an interest in the net assets of any entity). In addition, holding a cryptocurrency does not give an investor any contractual right with any known party.

Inventory

View 2G – A cryptocurrency is inventory.

Proponents of this view think that IAS 2 *Inventories* acknowledges non-physical inventories because it recognizes commodity broker-traders have inventory. Paragraph 3(b) of IAS 2 (i.e., the scope exclusion from the measurement requirements of IAS 2 for commodity broker-traders) is relevant. Some proponents think cryptocurrency is a commodity, citing the commonly accepted definition of a commodity quoted on Investopedia as being “a basic good used in commerce that is interchangeable with other commodities of the same type.”

Paragraph 3(b) of IAS 2 notes that the cost measurement basis does not apply to commodity broker-traders (i.e., those who buy or sell commodities for others or on their own account, and whose inventories are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders’ margin). Paragraph 5 of IAS 2 indicates that such broker-traders measure their inventories at fair value less costs to sell. When these inventories are measured at fair value less costs to sell, any changes in fair value less costs to sell are recognized in profit or loss in the period of the change.

View 2H – A cryptocurrency is not inventory.

Proponents of this view think that a cryptocurrency is not within the scope of IAS 2 because it is not the type of asset described in paragraphs 3(b) or 6 of IAS 2. They think that cryptocurrencies are mediums of exchange. Similar to the exclusion of cash and other financial instruments from the scope of IAS 2, they think that cryptocurrencies should be excluded.

Investment property

View 2I – A cryptocurrency can be analogized to an investment property in IAS 40 Investment Property*.*

Proponents of this view think that the GAAP Hierarchy permits an entity to apply judgment in developing an accounting policy when an IFRS Standard does not specifically apply, or the consequence of applying a more specific standard would result in financial statements that are not relevant.

Investors in a cryptocurrency generally hold it for use as a medium of exchange, or for capital appreciation, or both. Therefore, proponents look toward the definition of investment property in paragraph 5 of IAS 40. The fair value model that is available to investment properties results in more relevant financial reporting. Unlike the revaluation model in IAS 38, changes in the fair value of investment properties are recognized in profit or loss. Proponents also note that some analogize to an investment property when accounting for a gold bullion that is held for capital appreciation.

View 2J – A cryptocurrency cannot be analogized to IAS 40 Investment Property *because it is neither permitted nor appropriate.*

Based on the definition of investment property, proponents of this view think that the scope of IAS 40 is limited to real properties (i.e., land and buildings).

The Group's Discussion

The Group discussed the applicability of the accounting models outlined above. Group members thought that an entity should first analyze whether the cryptocurrency it holds would be within the scope of an existing IFRS Standard before considering the GAAP Hierarchy.

Some Group members acknowledged that IAS 38 seems most applicable given the standard addresses assets without physical substance. However, some Group members noted that the accounting result produced under the revaluation method for intangible assets does not provide meaningful information to users when compared to a fair value through profit or loss measurement approach. One Group member noted that paragraph 7 of IAS 38 states, in part, "[e]xclusions from the scope of a Standard may occur if the activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way."

The Group discussed the fair value through profit or loss measurement approach under the financial instruments standard. However, there are challenges with applying the definition of a financial asset to a cryptocurrency because no identifiable contractual arrangement exists with another party. The only way to monetize the asset is to buy goods or services, or sell the interest in the cryptocurrency to another third party. From this perspective, a cryptocurrency is similar to gold bullion, which is not a financial instrument. One Group member raised the question of whether a cost less impairment model together with relevant disclosures provide more meaningful information as there is significant pricing volatility associated with some cryptocurrencies in the market.

The Group also discussed whether cryptocurrency is cash. The point of contention is whether the cryptocurrency can be viewed as a medium of exchange. Although the term "medium of exchange" is not defined in IFRS Standards, the Group discussed the notion of widespread acceptance and observed that it is difficult to compare cryptocurrencies to existing cash or cash equivalent products in today's marketplace. One Group member also thought another factor to consider is whether a cryptocurrency would ever be regarded as a functional currency for preparing financial statements.

One Group member commented on the IAS 2 and IAS 40 models. If the entity is a commodity broker-trader of cryptocurrencies, the IAS 2 model may work and allow for a fair value less costs to sell measurement approach. However, the difficulty with applying the IAS 40 model is that the standard is intended for physical assets.

Representatives from the Canadian Securities Administrators (CSA) observed that transactions involving cryptocurrencies are beginning to percolate in the market. CSA Staff Notice 46-307 "Cryptocurrency Offerings" was issued to assist reporting issuers to determine if such offerings would be considered a security under securities law. Although the definition of a security under securities law is not the same as the definition of a financial instrument under IAS 32 *Financial Instruments: Presentation*, considering the guidance in the staff notice may complement an entity's analysis on the accounting for cryptocurrencies. An entity's analysis should also consider whether

there is an active market for the cryptocurrency it holds. Overall, the entity should clearly disclose the judgments applied in arriving at a certain accounting treatment.

The Group noted that IFRS Standards were designed before cryptocurrencies existed. As a result, providing financial information about a cryptocurrency that is relevant and faithfully representative within the existing confines of the IFRS Standards is difficult given the challenges pointed out with the various accounting models. The Group recommended that the issue be discussed with the AcSB to determine whether it should be raised to the IASB or the IFRS Interpretations Committee.

The IASB staff who observed the Group's discussion indicated that the IASB is actively monitoring the developments in this area.

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

IFRS 16: Fixed Payments and Variable Lease Payments

A lessee is required to initially measure the lease liability at the present value of the lease payments. Paragraph 27 of IFRS 16 *Leases* indicates the type of lease payments included in the measurement of the lease liability:

(a) fixed payments (including in-substance fixed payments) less any lease incentives receivable;

(b) variable lease payments that depend on an index or a rate;

(c) amounts expected to be payable by the lessee under residual value guarantees;

(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and

(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Paragraph B42 of IFRS 16 describes in-substance fixed lease payments as "payments that may, in form, contain variability but that, in substance, are unavoidable." Examples include:

(a) Payments structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance.

(b) There is more than one set of payments the lessee could make, but only one set of payments is realistic. In this case, the realistic set of payments is considered to be lease payments.

(c) There is more than one realistic set of payments the lessee could make, but it must make at least one of those sets of payments. In this case, the set of payments that aggregates to the lowest amount (on a discounted basis) is considered to be lease payments.

Variable lease payments that are linked to the future performance or use of the underlying asset are excluded from the measurement of the lease liability.

The Group discussed three fact patterns to highlight some of the principles and application guidance in IFRS 16 to determine which lease payments should be included or excluded from the initial measurement of the lease liability.

Fact Pattern 1

- An entity has a mine that is starting commercial production. The entity enters into a contract to lease substantially all of its critical mining and milling equipment. The lease has a term of 20 years, which is the estimated life of the mine.
- Lease payments are determined based on realized mineral extraction at a rate of $50 per unit of mineral product. There is no minimum payment. Based on the entity's mine plan, it expects that realized mineral extraction will be at least 100,000 units per annum.
- Assume the entity has determined that the contract contains a lease and that there are no non lease elements to the contract.

Issue 1: Is the following analysis appropriate in determining the lease payments that should be excluded from the initial measurement of the lease liability?

Analysis

Although the entity is able to estimate the minimum lease payments it will make over the lease term, the lease payments are solely linked to the usage of the underlying asset. If the entity did not achieve any realized mineral extraction, the minimum amount payable would be nil.

There is genuine variability to the lease payments and the variability will remain throughout the lease term. As a result, the entity will recognize lease payments as an expense in profit or loss when it realizes mineral extraction.

The Group's Discussion

Group members agreed with the above analysis.

Fact Pattern 2

- The facts and circumstances presented in Fact Pattern 1 are the same, except that there is a minimum fixed annual payment of $500,000 rather than a straight variable fee based on realized extraction. In addition, if realized extraction is more than 10,000 units per annum, the annual payment will be increased to $5 million. If realized extraction is more than 125,000 units per annum, the annual payment will be increased to $6 million.
- Based on the entity's mine plan, realized mineral extraction is expected to be at least 100,000 units per annum (i.e., it is very unlikely to be less than 10,000 units per annum). However, it is uncertain whether the realized mineral extraction will be more than 125,000 units per annum.

Issue 2: Which amount should be included in the initial measurement of the lease liability?

View 2A – Annual lease payments included in the lease liability should be $500,000.

Proponents of this view note that lease payments in excess of $500,000 per annum are considered variable lease payments. They should be excluded from the measurement of the lease liability because the payments are linked to the usage and performance of the underlying asset.

As a result, the entity will measure the lease liability based on annual payments of $500,000. The entity will expense additional payments of $4.5 million or $5.5 million in profit or loss in the years in which realized extraction exceeds the prescribed amounts.

View 2B – Annual lease payments included in the lease liability should be $5 million.

Proponents of this view look toward the guidance in paragraph B42(b) of IFRS 16. Although there is more than one set of payments, the entity determines a lease payment of only $500,000 is not realistic and, consequently, this set of payments should not be used in measuring the lease liability.

In addition, since there are more than one realistic set of payments, paragraph B42(c) of IFRS 16 indicates that the entity should consider the set of payments that aggregates to the lowest amount to be lease payments. Therefore, $5 million per annum should be used in measuring the lease liability.

The Group's Discussion

Group members supported View 2A because the lease payments in excess of $500,000 still contain variability as they are solely linked to the usage of the underlying asset.

One Group member noted that although there are limited sets of lease payments under Fact Pattern 2, variability still exists for the lease payments in excess of $500,000. For the in substance fixed payments guidance to apply, an entity would need to be able to articulate why the two fact patterns are different.

Fact Pattern 3

- The facts and circumstances presented in Fact Pattern 1 are the same, except that rather than a straight variable fee based on realized extraction, the lease payments are structured as follows:
  - (a) The initial monthly payments are first set at $300,000.
  - (b) The monthly payments will increase to $400,000 once the entity realizes mineral extraction of 120,000 for the previous 12-month period and remain fixed at this amount for the remainder of the lease.
- The lease agreement also requires that the monthly lease payments (either $300,000 or $400,000) increase every year on the basis of the increase in the applicable Consumer Price Index (CPI).
- After 30 months from the commencement date of the lease, the entity achieves realized mineral extraction of 120,000 units for the first time.

Issue 3: Is the following analysis appropriate in determining the initial measurement, and subsequent remeasurement, of the lease liability?

Analysis

Paragraph 27(b) of IFRS 16 requires variable lease payments that depend on an index or rate to be included in the initial measurement of the lease liability. In this example, the monthly payment of

$300,000 depends on an index. Therefore, the entity would use the CPI index at the commencement date of the lease (i.e., without factoring in future increases in CPI).

The additional monthly payment of $100,000 also varies depending on the same index, but is initially dependent on the usage or performance of the asset. The variability precludes this monthly amount from being included in the initial measurement of the lease liability.

The variability is resolved at month 30, which is the first time that the prior 12-month realized mineral extraction exceeds 120,000 units. At month 30, the entity will remeasure the lease liability based on a monthly lease payment of $400,000 for the remainder of the lease, adjusted as needed for changes in CPI since the commencement of the lease.

Other subsequent changes to the lease payments as a consequence of changes in the CPI index are reflected as adjustments to the lease liability when the changes have taken effect.

The Group's Discussion

Group members agreed with the analysis that the $300,000 monthly lease payment would be included in the initial measurement of the lease liability. At month 30, the entity would remeasure the lease liability using the increased monthly lease payment of $400,000 because the variability is resolved.

With respect to the CPI index, an entity would remeasure the lease liability only at the point when the lease payments are changed as a consequence of applying the CPI index formula, keeping the discount rate unchanged. The same approach is applied if the lease payments depend on an interest rate such as the London Interbank Offered Rate (LIBOR), except that the entity would use a revised discount rate that reflects the change in the interest rate in accordance with paragraph 43 of IFRS 16.

Overall, the Group's discussion on the three fact patterns raises awareness of the principles in IFRS 16 on fixed and variable lease payments. No further action was recommended to the AcSB.

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

IFRS 16: Future Lease Payments

IFRS 16 *Leases* defines lease term as follows:

> "The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:
>
> (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
>
> (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option."

Paragraph 19 of IFRS 16 states that "[i]n assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee

to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37–B40."

Fact Pattern 1

An entity requires its Board of Directors' (Board) approval before any renewal options in a lease agreement can be exercised. Usually, this approval is not obtained until three months before the lease renewal date.

Issue 1: How should the entity incorporate factors outside of management's control in determining whether it is reasonably certain to exercise the lease renewal option?

View 1A – The lease term should exclude the renewal option until Board approval is obtained.

An entity exercises judgment in determining the weight assigned to each factor considered. If the Board's approval is seen as a key determinant in the lease renewal decision, this may prohibit the inclusion of any renewal options in the lease term at the lease commencement date. This view is further supported if the Board has a history of rejecting lease renewals or makes lease renewal decisions using information that is unavailable to the entity at the lease commencement date.

Under this view, the lease term on initial recognition would exclude renewal options. When renewal options are subsequently approved by the Board, a reassessment of the lease term would be performed, and the lease liability would be remeasured to reflect this change.

View 1B – The lease term should include the renewal option when other factors support that the entity is reasonably certain of exercising such option.

Proponents of this view note that there is no single factor that is determinative in assessing the lease term. The entity should consider all available relevant factors in making the decision.

Board approval can be viewed as a final step in the lease-renewal process, and one that is controlled by the entity. In order to balance timeliness of financial reporting with reliability of the information presented, it would be appropriate for the entity to review all relevant and available information that the Board would ultimately consider. This information should be used to support an assessment for accounting purposes, independent of Board approval.

The entity should consider factors described in paragraph B37 of IFRS 16 in making its assessment of whether it is reasonably certain to exercise the renewal option. A subsequent rejection of a renewal option initially included in the lease term would require remeasurement of the lease liability at the time the decision is made.

The Group's Discussion

One Group member noted that the entity's requirement to have Board approval is a factor to be considered. Another Group member suggested that the Board's approval to renew the lease would be a final step after considering all economic factors that any member of the entity would have taken into consideration. As such, whether it is management or the Board that has the decision

making authority is not relevant because both would be expected to act in the entity's best economic interests.

Group members agreed that the lease term should include the renewal option when other factors support that the entity is reasonably certain of exercising such option (View 1B).

Fact Pattern 2

An entity is reasonably certain to exercise the renewal option in a lease. The renewal option does not specify the payment amounts but requires them to be at market rates.

Issue 2: How should the entity measure the lease liability when future lease payments upon renewal are not known until a later date?

View 2A – The renewal option should not be included on initial recognition of the lease.

Proponents of this view note that estimating the future lease payments in a renewal term is subject to significant measurement uncertainty. In certain industries with rapidly changing market conditions, it may be difficult to use historical rates as a basis for estimating future lease payments. Including such an estimate would reduce the quality of reported financial information.

The future lease payments contain an element of variability and may be contingent on factors unknown to the entity at the lease commencement date. Paragraph 27 of IFRS 16 requires the inclusion of variable lease payments in the measurement of a lease liability only when such payments are based on an index or rate.

Proponents of this view also considered paragraph 4.16 of the existing *Conceptual Framework for Financial Reporting* issued by the IASB in September 2010. This paragraph indicates the decision to acquire future assets does not give rise to a present obligation, unless there is an irrevocable agreement in place. The paragraph seems to suggest that when the renewal term has not yet been exercised or communicated, no legal or constructive obligation has been created. As such, there is no obligating event that would result in a liability.

View 2B – The renewal option should be included in the lease term at the same rate as the immediately preceding lease term.

Proponents of this view note that the determination of being reasonably certain to exercise a renewal option can be viewed as an acknowledgement of a present obligation. A key principle of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is that uncertainty is inherent in business decisions. Therefore, the standard allows for the use of estimates and management's judgment in many financial statement areas.

When a renewal option is included in the lease term, it is likely that the renewal rate will be at or above the rate in the preceding term in an inflationary environment. Absent contrary information, an entity should estimate the lease payments in a renewal term based on the current rate paid as this is a reliable estimate of the minimum future outflow. If the actual rate differs upon renewal, the lease liability would be remeasured to reflect this change.

View 2C – The renewal option should be included in the lease term with an adjustment to reflect an increase in future lease payments.

Proponents of this view note that an entity may be able to achieve an increased level of precision by making reasonable adjustments to the base lease rate in order to estimate future lease payments. When there is a history of rent escalation for a particular site, or a site with similar characteristics, it is unrealistic to assume that there will be no change to the current lease rate. A comparison of the lease rate to current market rates, real estate market trends, and other information available to the entity may also lead to the conclusion that the current rate is not the best estimate of the future outflow.

As noted in paragraph 33 of IAS 8, the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Therefore, an entity should consider all reliable information available, subject to the cost constraint, to determine the adjustment to future lease payments.

The Group's Discussion

The Group discussed economic considerations that could affect the likelihood of an entity renewing the lease. Economic factors to consider include costs of relocation, loss of customers and loss of existing infrastructure. When a decision to renew is reasonably certain after considering economic factors as in the fact pattern, the Group's view is that the renewal option should be included in the lease term (not View 2A).

Group members supported including the renewal term in the lease term at the same renewal rate as the immediately preceding lease term when measuring the future lease payments (View 2B). Including an adjustment to reflect an increase in future lease payments would be inconsistent with the guidance (View 2C).

One Group member emphasized that measuring the lease liability could be challenging and requires extensive effort, especially for entities with a large volume of leases.

The Group's discussion raises awareness about the consideration of renewal options when determining future lease payments. No further action was recommended to the AcSB.

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

IFRS 16: Lessee's Discount Rate

A lessee is required to initially measure the lease liability at the present value of the lease payments. Paragraph 26 of IFRS 16 *Leases* states, in part, the following:

> "The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate."

A lessee's incremental borrowing rate is defined as follows:

> "The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right of use asset in a similar economic environment."

Paragraphs BC160 to BC162 in the Basis for Conclusions on IFRS 16 provides additional guidance on the lessee's discount rate.

Fact Pattern 1

- Entity A is a start up entity and has never borrowed funds to operate other than in the form of convertible debentures. The interest rate used to determine the initial fair value of the liability component has been between 15 per cent and 30 per cent depending on the term of the debentures and whether the debentures are secured.
- On January 1, 2019, Entity A enters into a five-year contract to lease office space in a large office building with many tenants. The lease has a two year extension option that Entity A concludes it is not reasonably certain to exercise at the commencement date of the lease. The potential amounts to be recognized for the right-of-use asset and the lease liability are significant to Entity A. The interest rate implicit in the lease cannot be readily determined by Entity A.
- On January 1, 2023, due to a change in facts and circumstances, Entity A has decided it is now reasonably certain to exercise the extension option.

Issue 1: How should Entity A determine its incremental borrowing rate on the commencement date of the lease?

Analysis

Paragraph 26 of IFRS 16 is clear that a lessee must use its incremental borrowing rate if the interest rate implicit in the lease is not readily determinable. This requirement is applicable for Entity A even if there are other entities leasing office space in the same building that use a lower discount rate.

Entity A needs to determine its incremental borrowing rate by taking into account its credit standing, the length of the lease, the nature and quality of the collateral provided and the economic environment in which it operates and leases office space. This approach does not necessarily mean that Entity A's discount rate will be the same as that of its debt host in the convertible debenture. Rather, all facts and circumstances, including the existence of security in the underlying property, needs to be considered. Such an analysis may result in a lower discount rate attributed to the lease liability than to a convertible debt of a similar amount.

The above analysis would also be applicable to a start-up entity that has never borrowed funds before and only financed its operations through the equity it raised.

The Group's Discussion

Group members agreed with the above analysis.

The Group further discussed whether market rental rates for real estate that are easily observable could be used as a proxy for the incremental borrowing rate. Group members noted that market rental rates might not reflect the lessee’s own credit risk that is inherent in the lessee’s specific lease arrangement. The lessee’s own credit risk is required to be reflected in the determination of its incremental borrowing rate for that lease. Therefore, the measurement of the lease liability will be affected by the lessee’s own credit risk inherent in the lessee’s specific lease arrangement regardless of whether the discount rate is based on the lessor’s implicit lease rate or the lessee’s incremental borrowing rate.

The Group also observed that the level of effort to determine the incremental borrowing rate could be significant, especially for entities with a significant portfolio of leases.

Issue 2: What discount rate should Entity A use when it exercises a renewal option not previously included in the lease term?

Analysis

Paragraph 40(a) of IFRS 16 indicates that a lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate if there is a change in the lease term.

Paragraph 41 of IFRS 16 then states the following:

> “In applying paragraph 40, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.”

Therefore, on January 1, 2023, Entity A will estimate its incremental borrowing rate for the remaining three-year lease term using the same approach described under Issue 1, except that it will take into account any new facts and circumstances since the initial lease was signed.

The Group’s Discussion

Group members agreed with the above analysis.

Fact Pattern 2

- The facts and circumstances are the same as Fact Pattern 1, except that Entity A enters into the lease on January 1, 2018 and transitions to IFRS 16 on January 1, 2019.
- Furthermore, the lease is with another entity in a related party group and is on market terms. Entity A is able to determine the interest rate implicit in the lease.

Issue 3: When an entity applies paragraph C8(a) of IFRS 16, does it have the choice to use either its incremental borrowing rate or the interest rate implicit in the lease?

When an entity elects to apply IFRS 16 retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application, paragraph C8(a) of IFRS 16 applies. This paragraph requires a lessee to recognize and measure the lease liability on the date of application using the lessee’s incremental borrowing rate at that date. There is no mention of whether an entity can use the interest rate implicit in the lease.

The two views are as follows:

- *View 3A – No, a lessee should use its incremental borrowing rate*
- *View 3B – Yes, an entity can elect to use either its incremental borrowing rate or the interest rate implicit in the lease.*

The Group's Discussion

Group members supported the view that the lessee should use its incremental borrowing rate (View 3A). Paragraph C8(a) of IFRS 16 is applicable only when an entity elects to apply the standard retrospectively in accordance with paragraph C5(b) of IFRS 16. The transition guidance provides a practical expedient to avoid the challenges of determining the interest rate implicit in the lease as it would involve the use of hindsight.

Issue 4: When an entity applies paragraph C8(a) of IFRS 16, should the interest rate used reflect the original term of the lease or the remaining term of the lease as at the date of initial application?

Paragraph C8(a) of IFRS 16 does not specify whether the interest rate used should reflect the original term of the lease or the remaining term of the lease.

The two views are as follows:

- *View 4A – The discount rate should reflect the remaining term of the lease.*
- *View 4B – An entity can elect an accounting policy choice, applied consistently at the date of initial application of IFRS 16, to use either a discount rate which reflects the remaining term of the lease or the original lease term.*

The Group's Discussion

Group members agreed that the transition guidance in IFRS 16 does not address whether the interest rate used should reflect the original term of the lease or the remaining term of the lease on initial application under paragraph C8(a) of IFRS 16. One Group member noted that an entity could make an accounting policy choice in this area, which would appear to be consistent with one of the U.S. accounting firms' interpretation of U.S. GAAP (View 4B).

Nevertheless, most Group members agreed that the purpose of the transition guidance is to alleviate practical challenges, including the use of hindsight. Therefore, it would be consistent and practical for the discount rate to reflect the remaining term of the lease as at the date of initial application (View 4A).

One Group member clarified that if the original lease term was used, the discount rate should reflect the market conditions at the date of initial application.

Overall, the Group's discussion raises awareness about the determination of the lessee's discount rate when measuring a lease liability. No further action was recommended to the AcSB.

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

IFRS 16: Lease Incentive

Lease incentives can take many forms. They are defined in Appendix A of IFRS 16 *Leases* as "payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee."

Paragraph 24(b) of IFRS 16 states that "the cost of the right-of-use asset shall comprise any lease payments made at or before the commencement date, less any lease incentives received."

However, the last paragraph under Part 1 of Illustrative Example 13 of IFRS 16 states the following:

> "Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying IFRS 16. This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right of use asset."

Issue: Are all lease incentives, including leasehold improvements, reduced from the right-of-use asset at initial recognition?

View A – All lease incentives, including leasehold improvements, are reduced from the right-of-use asset at initial recognition.

Proponents of this view consider that all incentives for the agreement of a new or renewed lease should be recognized as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive's nature or form, or timing of payments.

Paragraph 24(b) of IFRS 16 and the definition of lease incentives clearly support that all lease incentives, in whatever form and nature, is reduced from the cost of the right-of-use asset at initial recognition. Such incentives include leasehold improvements as no specific distinction between leasehold improvements and other lease incentives is contemplated by the authoritative guidance under IFRS 16. The Illustrative Example is only meant to accompany, but is not part of, IFRS 16.

View B – Lease incentives that relate to reimbursement of leasehold improvements or other costs that are addressed by other IFRS Standards, are accounted for in accordance with those relevant standards; and any other lease incentives are reduced from the right of-use asset at initial recognition.

Proponents of this view consider that Illustrative Example 13 in IFRS 16 is relevant in creating a distinction between leasehold improvements and other lease incentives.

The guidance provided in this Illustrative Example is also similar to the existing guidance in SIC Interpretation 15 *Operating Leases — Incentives*. Paragraph 6 of SIC 15 states "[c]osts incurred by the lessee, including costs in connection with a pre-existing lease (for example costs for termination, relocation or leasehold improvements), shall be accounted for by the lessee in accordance with the Standards applicable to those costs, including costs which are effectively reimbursed through an incentive arrangement."

The Group's Discussion

Group members generally viewed Illustrative Example 13 of IFRS 16 to be in conflict with the leases standard. One Group member speculated that the distinction of leasehold improvements from a

lease incentive may have stemmed from the lessor's perspective. To the lessor, leasehold improvements could, in certain circumstances, be viewed as a payment for the lessor's own capital additions unlike an incentive payment. Some Group members noted that such a distinction is not in the standard, and would like to understand whether the distinction was purposeful.

The majority of the Group held the view that illustrative examples are not authoritative and that IFRS 16 is clear that all lease incentives are reduced from the right-of-use asset at initial recognition (View A).

The Group's discussion raises awareness about the consideration of lease incentives when measuring right-of-use assets. The Group recommended that the disconnect between IFRS 16 and the Illustrative Example 13 be discussed with the AcSB to determine whether the issue should be raised to the IASB or the IFRS Interpretations Committee.

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

IFRS 15: Changes in Transaction Price

In many contracts, the transaction price can change for various reasons. For example, the resolution of uncertain events or changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services can occur.

Paragraph 59 of IFRS 15 *Revenue from Contracts with Customers* states the following:

> "At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with paragraphs 87–90."

Paragraph 88 of IFRS 15 states the following:

> "An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes."

Paragraph 85 of IFRS 15 provides guidance on assessing whether an entity should allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation, or to a distinct good or service that forms part of a single performance obligation. If the criteria in this paragraph are not met, the entity applies the general allocation requirements in paragraphs 76-80 of IFRS 15 (i.e., allocate based on stand-alone selling prices).

Fact Pattern

The following fact pattern is derived from Illustrative Example 35 of IFRS 15, *Case B–Variable consideration allocated on the basis of stand-alone selling prices*.

- An entity enters into a contract with a customer to sell two intellectual property licences (i.e., Licences X and Y) which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences X and Y are CU800 and CU1,000, respectively.
- The price stated in the contract for Licence X is a fixed amount of CU300 and for Licence Y the consideration is five per cent of the customer's future sales of products that use Licence Y. The entity's estimate of the sales-based royalties (i.e., the variable consideration) is CU1,500.
- The entity determines that it must allocate the transaction price using the general allocation requirements. Even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence Y (i.e., the customer's subsequent sales of products that use Licence Y), allocating the variable consideration entirely to Licence Y does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences X and Y of CU800 and CU1,000, respectively.
- As a result, the entity allocates the transaction price of CU300 to Licences X and Y on the basis of relative stand-alone selling prices of CU800 and CU1,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, in accordance with paragraph B63 of IFRS 15, consideration in the form of a sales-based royalty cannot be recognized as revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).
- Licence Y is transferred to the customer at the inception of the contract and Licence X is transferred three months later. When Licence Y is transferred, the entity recognizes as revenue CU167 (CU1,000 ÷ CU1,800 × CU300) allocated to Licence Y. When Licence X is transferred, the entity recognizes as revenue CU133 (CU800 ÷ CU1,800 × CU300) allocated to Licence X.
- In the first month, the royalty due from the customer's first month of sales is CU200.

Issue: Assuming that the change is not considered a contract modification under IFRS 15, how should the change in transaction price be accounted for?

Analysis

According to paragraph 88 of IFRS 15, the entity should allocate the change in transaction price to the satisfied and unsatisfied performance obligations in the contract on the same basis as at contract inception.

The entity recognizes CU111 as revenue. This represents the proportion of royalty due from the customer's first month of sales of CU200 allocated using the initial allocation to Licence Y (CU1,000 ÷ CU1,800 × CU200). As Licence Y has been transferred to the customer and is, therefore, a satisfied performance obligation, revenue is recognized.

In addition, the entity allocates a proportion to Licence X based on the initial allocation. The entity recognizes a contract liability for CU89 (CU800 ÷ CU1,800 × CU200) allocated to Licence X because although the subsequent sale by the entity’s customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

The Group's Discussion

Group members agreed with the above analysis. The change in transaction price occurs when the customer sells the product that uses Licence Y because this is a sales-based arrangement. The consideration to which the entity is entitled changes from CU300 at inception to CU500 when the royalty is due from the customer's first month of sales.

If there was a change in the stand-alone selling prices of Licences X and Y, paragraph 88 of IFRS 15 would prohibit reallocating the transaction price using the updated stand-alone selling prices. In this fact pattern, the requirement to allocate the change in transaction price arises because one of the performance obligations has not been satisfied. Once all performance obligations have been satisfied, the entity recognizes revenue when the royalty is due.

The Group observed that changes in transaction price are commonly found in contracts that have variable consideration, and many industries have such types of contracts. The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IFRS 16 and IAS 38: Cloud Computing Arrangements

The Group initially discussed this topic at its September 2015 meeting. Since then, IFRS 16 *Leases* was issued. The U.S. Financial Accounting Standards Board's Emerging Issues Task Force has also been re-considering the current U.S. GAAP accounting model for cloud computing arrangements (see project page).

To date, there is no specific guidance in IFRS Standards that addresses the customer's accounting in cloud computing arrangements. In this meeting, the Group focused on the type of cloud computing arrangements in which the customer pays fees to the supplier to access the supplier's hardware and application software. There are certain aspects of IFRS 16 *Leases* and IAS 38 *Intangible Assets* that are relevant in considering the accounting for these arrangements. If these arrangements are not within the scope of either IFRS 16 or IAS 38, the cost would be expensed as the services are provided. The Group discussed five issues using three fact patterns to navigate through the relevant IFRS Standards from the customer's perspective.

Fact Patterns

1. A right to access non-dedicated supplier hardware and supplier application software (Scenario X).
2. Same as Scenario X except the customer has a right to possess a copy of the application software (Scenario Y).
3. Same as Scenario X except the customer specifies particular application software configuration settings (Scenario Z).

Issue 1: Do the arrangements create intangible assets within the scope of IAS 38?

Analysis

The definition of an intangible asset (i.e., identifiability, control over a resource and existence of future economic benefits) needs to be considered. Scenarios X, Y and Z would likely satisfy the identifiability and existence of future economic benefits criteria, but it is questionable whether the control criterion is satisfied.

Paragraph 13 of IAS 38 states, in part, that “[a]n entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.” The key issue is how the term “underlying resource” is considered. If the underlying resource is the customer’s right of access, the customer has control as others are unable to utilize that customer’s specific right. However, if the underlying resource is the hardware and application software, the customer’s right of access may not satisfy the intangible asset definition, absent other arrangement features (i.e., hardware or application software wholly dedicated to the customer).

Assuming that the underlying resource is the hardware and application software, paragraph 4 of IAS 38 supports that the application software should be assessed separately from the hardware because it is not an integral part of the related hardware.

The non-dedicated hardware would fail the definition of control in all scenarios absent other arrangement features. However, the non-dedicated application software may satisfy the control definition in Scenario Y given the customer’s right to possess a copy of the application software and restrict the access of others to benefit from that specific copy. For Scenario Z, the question is whether a right to access application software with customer-specific configurations is sufficient to satisfy the control criterion (i.e., create an identifiable version of the software to obtain future economic benefits and restrict the access of others to those benefits).

The Group’s Discussion

Based on existing guidance in IAS 38, there were diverse views regarding whether the underlying resource is the customer’s right of access or the hardware and application software. Group members acknowledged that establishing what is the underlying resource is a key decision point in determining which IFRS Standard to apply.

A Group member noted that the interplay between IAS 38 and IFRS 16 is problematic. The right of access is something that an intangible asset would represent. However, the right of access is also like a lease in that the customer is leasing the supplier’s hardware or software application. Whether the right of access meets the definition of a lease is another question but this interplay makes analyzing cloud computing arrangements challenging.

In terms of assessing the application software separately from the hardware, most Group members agreed with the analysis because these two components of the underlying resource are two separate units of account. This view is predicated on the assumption that the underlying resource is not the customer’s right of access.

In considering whether certain characteristics of the arrangement establish an intangible asset, a Group member observed that a right to possess a copy of the application software makes it easier to satisfy the control criterion. However, the arrangements observed in practice thus far are more similar to Scenario Z. A factor to consider in assessing control for Scenario Z is the extent of configuration specified by the customer and the transferability of the configurations after the agreement with the supplier ends.

Issue 2: Do the arrangements or components in Scenarios X to Z meet the definition of a lease in IFRS 16?

Analysis

Paragraph 9 of IFRS 16 states, in part, that "[a] contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration."

Paragraph B9 of IFRS 16 indicates that to assess for the right to control, the customer has to have:

(a) the right to obtain substantially all of the economic benefits from the use of the identified asset; and

(b) the right to direct the use of the identified asset.

Paragraph B12 of IFRS 16 also indicates that an entity needs to assess whether a contract contains a lease for each potential separate lease component. Referring to the guidance in paragraph B32 of IFRS 16, the right to use an underlying asset is a separate lease component if both:

(a) the lessee can benefit from the use of the underlying asset on its own or together with other resources that are readily available to the lessee; and

(b) the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

The underlying assets in the contract are the hardware and application software. If there are substantive substitution rights, the arrangement would not qualify as a lease.

Further, for Scenario X, it is unlikely that the customer would have the right to obtain substantially all the economic benefits given the potential for others to use the same hardware and application software. Therefore, the arrangement is unlikely to meet the definition of a lease.

For Scenario Y, the hardware component would not satisfy the lease definition given it is not dedicated to the customer. However, the right to possess the application software appears to provide the customer with the right to obtain substantially all the economics benefits from that copy of the application software and the right to direct its use. Based on paragraph B32 of IFRS 16, the application software should be assessed separately from the hardware. The customer's right to possess the application software may indicate that the customer could benefit from the software on its own or together with other available computing resources, and the software is neither highly dependent on, nor highly interrelated with, the hardware in the contract.

For Scenario Z, the hardware component would not satisfy the lease definition. However, there is a question as to whether the customer-specified application software configuration settings create an

identifiable version of the software that provides the customer with the right to obtain substantially all the economic benefits and the right to direct its use. In addition, in terms of applying paragraph B32 of IFRS 16, since the customer does not have the right to possess the application software, it is unclear whether the software is considered highly dependent on, or highly interrelated with, the hardware in the arrangement.

The Group's Discussion

A Group member noted that there is overlap between IAS 38 and IFRS 16 with respect to the concept of control. However, under IFRS 16, an entity is determining whether the right of access is a lease and looks at the underlying assets to determine if it has the right to obtain substantially all economic benefits from, and direct the use of, the identified assets.

Group members agreed with the analysis that there is no lease in Scenario X and there is no lease for the hardware component in Scenarios Y and Z. For Scenarios Y and Z, Group members agreed that the definition of a lease should be applied separately to the hardware and application software.

Similar to Issue 1, the right of possession is a persuasive characteristic that could support there is a lease. The extent of customer-specified configuration settings, or the customer's ability to request the return of the configuration settings, which may be akin to having a right of possession, could also support that there is a lease. Group members acknowledged that there are more hurdles to overcome in determining whether there is a lease if the arrangement does not have a right of possession.

An additional point was made that the arrangement needs to provide the customer with the ability to exercise the right to control, and that whether the customer intends to exercise such a right is not relevant.

Issue 3: Does paragraph 3(e) of IFRS 16 only apply to the licensing arrangements listed therein, or does it apply broadly to all licensing arrangements including software licences?

IFRS 16 does not define the term "licensing arrangements". However, paragraph 3(e) of IFRS 16 states that the standard does not apply to "rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights." Given the reference to lessee, this scope exclusion seems to indicate that IAS 38 is applied rather than IFRS 16 when a qualifying intangible asset is acquired but the arrangement also meets the definition of a lease.

View 3A – Paragraph 3(e) of IFRS 16 applies narrowly to the licensing arrangements listed therein.

Proponents of this view think the scope exclusion is specific to those licensing arrangements listed in paragraph 3(e) of IFRS 16. Other licensing arrangements that qualify as intangible assets and meet the definition of a lease are not automatically scoped out of IFRS 16.

An entity has an accounting policy choice based on paragraph 4 of IFRS 16, which states "[a] lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(e)."

View 3B – Paragraph 3(e) of IFRS 16 applies broadly to all licensing arrangements.

Proponents of this view think that the licensing arrangements in paragraph 3(e) of IFRS 16 are only examples instead of an exhaustive list. Other licensing arrangements that qualify as intangible assets and meet the definition of a lease are automatically scoped out of IFRS 16.

The Group's Discussion

Several Group members observed that the words "such items as" in paragraph 3(e) of IFRS 16 supported a broader interpretation that the paragraph applies to all licensing arrangements (View 3B). A few Group members acknowledged that there are arguments for both views.

Issue 4: Assuming View 3B applies, how does an entity determine whether the arrangement contains a software licence?

Analysis

For Scenario X, the analysis in Issue 2 suggests that the arrangement would not meet the definition of a lease. Therefore, there is no scoping conflict between IFRS 16 and IAS 38.

However, for Scenarios Y and Z, the analysis suggests that the application software component may meet both the definition of an intangible asset and a separate lease component. If this is the case, an entity needs to consider whether such a software component constitutes a licensing arrangement to determine whether it is scoped out of IFRS 16 by paragraph 3(e) of the standard.

Under U.S. GAAP, Accounting Standards Codification (ASC) 350 *Intangible Assets–Goodwill and Others* establishes that for arrangements to include a software licence, they need to meet both of the following criteria:

(a) The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty.

(b) It is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

View 4A – To represent a licensing arrangement, the customer must have the right to possess a copy of the software.

Under this view, if the U.S. GAAP definition was used, the application software lease component would be considered a licensing arrangement in Scenario Y, and therefore, would be scoped out of IFRS 16.

View 4B – A licensing arrangement is considered broadly as a customer's right to intellectual property.

Under this view, there is little economic difference between Scenarios Y and Z. Therefore, the licensing arrangement should encompass the application software lease component in both scenarios.

The Group's Discussion

A few Group members noted that the ambiguity between paragraphs 3(e) and 4 of IFRS 16 makes it difficult to express a view on this issue. To explain, paragraph 3(e) of IFRS 16 explicitly scopes out certain items that meet the definitions of both a lease and an intangible asset. However, paragraph 4 of IFRS 16 indicates that an entity has a choice to apply IFRS 16 to other items outside paragraph 3(e) of IFRS 16 that also meet the definitions of both a lease and an intangible asset. The distinguishing factor between the two paragraphs is unclear, which makes it difficult to understand what the term "licensing arrangements" is intended to capture in paragraph 3(e) of IFRS 16.

Issue 5: If the arrangement includes an asset that is within the scope of IAS 38 and outside the scope of IFRS 16, what issues arise in measuring the asset and liability?

Analysis

An entity would recognize an asset similar to a right-of-use asset. However, there are many questions around how to measure the liability related to the acquisition of the intangible asset such as determining the term, which payments to include in the measurement of the liability, allocating payments to different components, etc. While there are many issues similar to those encountered in an IFRS 16 lessee model, it is not clear whether it would be appropriate for an entity to apply the guidance in IFRS 16 to an IAS 38 model.

The Group's Discussion

Group members agreed with the above analysis that there are many measurement issues to consider if the arrangement is accounted for under IAS 38.

The Group also had a brief discussion about executory contracts (also referred to as supply or service contracts). Absent specific guidance in IFRS Standards, it is possible that some types of cloud computing arrangements could be considered simply executory contracts.

One Group member observed that Scenarios X and Z are difficult to differentiate from an executory contract. However, the right of possession in Scenario Y is a stronger differentiating characteristic that may support recognizing an asset and liability in the Statement of Financial Position. Another Group member agreed that Scenario X is more akin to an executory contract, but thought that in Scenario Z, the existence of customer-specified configuration settings is similar to the "specialized nature" concept for finance leases found in IAS 17 *Leases*. Some Group members thought that it may be reasonable to treat a cloud computing arrangement as an executory contract when there are no rights of possession or extensive customer-specified configuration settings.

In summary, the Group's discussion of Issues 1 to 5 illustrates a thought process that entities can apply when determining the accounting for arrangements in which the customer pays fees to the supplier to access the supplier's hardware and application software. The Group observed that cloud computing arrangements are becoming more prevalent among private sector entities. Given there is no clear guidance in IFRS Standards and the U.S. GAAP model is being reconsidered, the Group recommended that the issues in this agenda item be discussed with the AcSB to determine whether they should be raised to the IASB or IFRS Interpretations Committee.

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

IFRS 9 and IFRS 15: Scope Interactions

The first step of the new model for revenue recognition requires that an entity determine if a contract exists and whether the contract is with a customer. IFRS 15 *Revenue from Contracts with Customers* applies to all contracts with customers, except for contracts that are within the scope of other standards, such as leases, insurance, and financial instruments.

An entity needs to consider all other potentially relevant accounting literature before concluding that the arrangement is within the scope of the revenue standard. If another standard only applies to a portion of the contract, the entity would need to separate the contract.

There are other interactions between the revenue standard and other standards as well. For example, IFRS 15 deals with the initial recognition of accounts receivable from revenue transactions. Subsequent to initial recognition, IFRS 9 *Financial Instruments* applies to accounts receivable.

The following fact patterns examine the interaction between IFRS 9 and IFRS 15. Specifically:

(a) credit losses, price concessions and discounts;

(b) commodity sales agreements in which the pricing is based on the future commodity prices; and

(c) disclosure of contract assets.

Fact Pattern 1

Entity A recognizes a number of adjustments to accounts receivable balances subsequent to invoicing for goods once control has been transferred. These adjustments include price concessions, volume discounts and credit losses.

Issue 1: Is the following analysis appropriate in determining whether the adjustment is accounted for under IFRS 9 or IFRS 15?

Analysis

The nature of the underlying adjustment should be assessed to determine whether the adjustment is accounted for under IFRS 9 or IFRS 15. An entity should consider the definition of credit loss under IFRS 9 and the definition of variable consideration under IFRS 15 in making this assessment. For example, paragraph 51 of IFRS 15 states, in part, that “[a]n amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items.”

The nature of the underlying adjustment would be determined based on the relevant facts and circumstances. For some entities, this may be an area of significant management judgment.

The Group’s Discussion

Group members agreed with the analysis, emphasizing that the nature of the adjustment is relevant, as opposed to how the adjustment is labelled in the invoice. For example, price concessions can vary in nature. If the price concession was provided because of unanticipated credit issues with the customer, such an adjustment would be within the scope of IFRS 9. If, instead, the price concession

was provided as a new feature of the contract, the question becomes whether there is a contract modification, which would then be within the scope of IFRS 15.

One Group member noted that Illustrative Example 40 of IFRS 15 is helpful in explaining the scope considerations. The accounts receivable balance is within the scope of IFRS 9 because it represents the entity's unconditional right to consideration. However, the volume discount is recognized as a contract liability because it is a separate unit of account from the entity's unconditional right to consideration. The volume discount is subject to variability, which is considered variable consideration within the scope of IFRS 15. If the entity did not account for the volume discount separately, the entire receivable would fail the solely payments of principal and interest test in IFRS 9 and be measured at fair value through profit or loss.

Another Group member commented that in practice, it is not unusual for an entity to bundle multiple adjustments and settle them together with a customer (e.g., settling historical price concession claims together with making a modification to the customer contract). Entities need to deconstruct the settlement to determine which amounts are within the scope of IFRS 9 or IFRS 15, taking materiality into consideration.

Fact Pattern 2

A mining entity enters into a contract to sell 1,000 tons of Commodity X to a customer on December 1, 20X7. The final price will be based on the Official Metal Exchange commodity price three months from the date of delivery.

Delivery takes place on December 30, 20X7 and control of Commodity X is transferred to the customer on that date. Final invoicing will take place on March 31, 20X8.

The entity has a December 31 year-end. The three-month forward Commodity X price on December 30 is $6,500 per tonne. On March 31, 20X8, the Commodity X price amounts to $6,750 per tonne. These contracts are frequently referred to as provisional pricing arrangements.

Issue 2: Does the provisional pricing arrangement represent a sales contract with an embedded derivative within the accounts receivable, or variable consideration?

View 2A – The provisional pricing arrangement represents a sales contract with an embedded derivative within the accounts receivable.

Proponents of this view think that at contract inception (i.e., December 1, 20X7), the provisional pricing arrangement represents an embedded derivative in the host sales contract. Revenue will be recognized on December 31, 20X7, the date when control of the commodity is transferred to the customer and the performance obligation is satisfied in accordance with IFRS 15.

The embedded derivative relates to the accounts receivable, which is recognized and measured based on IFRS 9. The embedded derivative would typically cause the receivable to fail the "solely payments of principal and interest" test under IFRS 9; meaning the receivable would need to be measured at fair value through profit or loss.

Under this view, the presentation of changes in the fair value of the receivable between the initial recognition date and final payment will also be affected. The change in fair value relating to the receivable would not represent revenue from contracts with customers for purposes of disclosure

under IFRS 15. However, it may be appropriate to present as other revenue, or a similar description.

View 2B – The provisional pricing arrangement represents variable consideration.

Proponents of this view think that the provisional pricing arrangement constitutes variable consideration to be accounted for in accordance with IFRS 15 and not a financial asset within the scope of IFRS 9.

The mining entity would need to apply judgment in: (i) estimating the variable sales price at December 31, 20X7; and (ii) determining whether the estimate meets the "highly probable" test regarding the likelihood of significant reversal. Judgment is also required to identify the point at which the variable consideration becomes unconditional and is therefore considered a financial asset within the scope of IFRS 9.

Under this view, the variable consideration recognized would be included in the IFRS 15 disclosures.

The Group's Discussion

Group members supported that the provisional pricing arrangement in the fact pattern represents a sales contract with price variability that is not variable consideration because the final price is indexed to the Official Metal Exchange commodity price (View 2A). There is no uncertainty regarding the entity's entitlement to the consideration, as the performance obligation has been satisfied. Therefore, there is no variability to account for under IFRS 15.

The Group also discussed a more complicated situation in which the quantity can vary. For example, an entity has fulfilled its performance obligation to deliver gold, but the actual number of ounces of gold delivered is not known until the refinement process is complete in addition to containing provisional pricing.

If the adjustment to the quantity delivered is viewed as confirming the actual quantity delivered, the adjustment should be treated as a true-up to the revenue initially recognized and the receivable amount. However, if the quantity adjustment resulted from more than just a confirmation process and the adjustment is not regarded as variable consideration, the entity may have an embedded derivative within the accounts receivable. In this case, the accounting is the same as View 2A. Since the arrangement contains a host that is a financial asset within the scope of IFRS 9, the entire arrangement including the embedded derivatives related to quantity and provisional pricing, would be assessed for classification under IFRS 9. The embedded derivatives would cause the receivable to fail the solely payments of principal and interest test and, therefore, the asset as a whole would be measured at fair value through profit or loss.

However, if the adjustment to the quantity delivered is considered variable consideration, the entity would have a contract asset with an embedded derivative. The contract asset is within the scope of IFRS 15 and not a financial asset within the scope of IFRS 9. Therefore, the embedded derivative for provisional pricing is separated from the contract asset and measured at fair value through profit or loss.

Fact Pattern 3

IFRS 15 contains certain disclosure requirements relating to contract assets. IFRS 7 *Financial Instruments: Disclosures* contains several disclosure requirements relating to financial assets.

Issue 3: Does a contract asset meet the definition of a financial asset such that IFRS 7 disclosures would be applicable?

Analysis

IFRS 15 requires that contract assets be assessed for impairment based on the provisions in IFRS 9. This requirement does not mean that a contract asset meets the definition of a financial asset and is subject to the IFRS 7 disclosure requirements.

This view is also consistent with the Basis for Conclusions on IFRS 15, in which the IASB specifically addressed possible contradictions between the scope provisions of IFRS 9 and IFRS 15. Paragraph BC63 in the Basis for Conclusions on IFRS 15 states, in part, the following:

> "The IASB noted that the requirements in paragraph 5 of IFRS 15 (together with paragraph 2(k) of IAS 39 *Financial Instruments: Recognition and Measurement*, which is a consequential amendment to IAS 39 added by IFRS 15) are clear that when a contract asset is within the scope of IFRS 15, it is not within the scope of IFRS 9."

The Group's Discussion

Group members agreed with the analysis above.

Overall, the Group's discussion of the three fact patterns raises awareness about the different factors to consider when analyzing whether a contract, or a portion of the contract, is within the scope of IFRS 9 or IFRS 15. No further action was recommended to the AcSB.

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

IFRS 9: Modifications or Exchanges of Financial Liabilities that do not Result in Derecognition

At its May 2017 meeting, the Group discussed the IFRS Interpretations Committee's tentative agenda decision relating to the accounting for modifications or exchanges of financial liabilities measured at amortized cost that do not result in derecognition. The IFRS Interpretations Committee concluded that an entity applies paragraph B5.4.6 of IFRS 9 to such transactions and a gain or loss should be recognized in profit or loss at the date of modification or exchange. This conclusion is consistent with the requirements in paragraph 5.4.3 of IFRS 9 on the accounting for modifications of financial assets, which is new wording introduced in the financial instruments standard.

The IASB agreed with this technical conclusion. To highlight this matter, the clarification on the accounting for modifications or exchanges of financial liabilities was included in the Basis for Conclusions on IFRS 9 *Financial Instruments* in the amendments to IFRS 9 for "Prepayment Features with Negative Compensation". These amendments were issued in October 2017, and are to be applied retrospectively for fiscal years beginning on or after January 1, 2019 with early application permitted.

The Group discussed four issues to highlight when the clarification should be applied and whether it applies to the accounting for modifications of floating rate debt.

Issue 1: When should the clarification on the accounting for modifications or exchanges of financial liabilities that do not result in derecognition be applied by entities?

Analysis

The IASB's clarification was not issued as an amendment to the existing requirements of IFRS 9. Rather, it was included in the Basis for Conclusions (i.e., paragraphs BC4.252 and BC4.253) as a clarification of IFRS 9 as originally issued. Therefore, the clarification should be incorporated as part of an entity's adoption of IFRS 9 (i.e., for periods beginning on or after January 1, 2018 for most entities).

The Group's Discussion

Group members agreed with the above analysis and noted that the clarification is to be applied retrospectively. If an entity adopts IFRS 9 on a retrospective basis without restating prior period comparatives, the cumulative effect is recognized in opening retained earnings at the date of initial application.

Issue 2: Does the clarification apply to modifications of floating rate debt?

The IASB and IFRS Interpretations Committee's discussions focused on an example of a fixed interest rate debt with a fixed term. However, there was no mention of modifications of floating rate debt.

Paragraph B5.4.5 of IFRS 9 describes an effective interest rate approach when the interest rate is reset to market rates each period.

View 2A – No.

Paragraph 12 of the July 2017 IASB Staff Paper (AP3B) notes the following:

> "We note that paragraph B5.4.5 of IFRS 9 applies only to floating-rate financial instruments. When their cash flows are re-estimated to reflect movements in market rates of interest, the effective interest rate is updated. Paragraph B5.4.6 of IFRS 9, on the other hand, applies to fixed-rate instruments and will usually result in a change in the instrument's carrying amount because the revised estimated cash flows are discounted at the original EIR [Effective Interest Rate]. The adjustment is recognised in profit or loss. Accordingly, applying the requirements in IFRS 9, we think an entity cannot analogise to paragraph B5.4.5 to account for modifications or exchanges of fixed-rate instruments."

Based on the above, proponents of this view think that the clarifications do not apply to modifications of floating rate debt. According, if the conclusion was that a non-substantial modification was the result of the outcome of the "10 per cent" test, then there would be no modification gain or loss recognized.

View 2B – Yes.

Proponents of this view note that paragraph 5.4.3 of IFRS 9 is applicable to floating rate debt as there is no explicit guidance in IFRS 9. However, there are different approaches to applying the effective interest method for a floating rate instrument. Therefore, a consistent approach to dealing with modifications should be applied.

The Group's Discussion

Group members agreed that the clarification applies to floating rate debt (View 2B).

Different from View 2A, a Group member thought that paragraph B5.4.5 of IFRS 9 just explains the outcome of the amortized cost accounting approach for a pure floating rate financial instrument issued at par with no premium or discount, and no cost or fees. In such circumstances, when the rate is reset for movements in market rates, there is normally no adjustment to the instrument's carrying amount because the entity updates the effective interest rate. However, paragraph B5.4.5 of IFRS 9 implies that there could be a gain or loss adjustment if the instrument is not a pure floating rate financial instrument. The clarification requires that an entity apply amortized cost accounting when there is a modification. Applying such an accounting approach could lead to a gain or loss if there were fixed elements in the prior effective interest rate of the floating rate instrument that were caused, for example, by an original issue premium or discount, fees and costs or a fixed spread.

Issue 3: Does the clarification apply when the floating rate debt has a fixed credit spread that changes in modification?

View 3A – No

This view is similar to View 2A. Also, proponents of this view think that the clarification still does not apply because the base interest rate is floating.

View 3B – Yes

Proponents of this view think that the credit spread effectively introduces a fixed component to the otherwise floating rate. As a result, there is a possibility that there could be a modification gain or loss when the fixed credit spread changes. Depending on the magnitude of the fixed credit spread compared to the floating component, the instrument may behave more like a fixed rate instrument. The modification must be analyzed to determine if there would be a gain or loss to recognize.

The Group's Discussion

Group members agreed that the clarification also applies when the floating rate debt has a fixed credit spread (View 3B), albeit the mathematical computation would be more complex compared to the situation in Issue 2.

The entity would calculate the gain or loss on the differential between the original and new fixed credit spreads and recognize the amount in profit or loss. The result is that the entity continues to recognize the amortized cost of the floating rate debt using the original fixed credit spread (assuming no fees or costs are incurred to effect the modification).

A Group member noted that it is difficult to apply a pure effective interest rate model when the floating rate financial instrument is mixed with fixed and variable elements. In practice, entities

sometimes apply a straight-line approach to the fixed element of the instrument, especially if the fixed element represents transaction costs, and use the effective interest rate method for the variable element on the basis of materiality.

Issue 4: Assuming the clarification applies when the fixed credit spread changes (View 3B), would the lack of prepayment penalty change whether the clarification still applies?

Modifications of debt instruments before maturity are often achieved by prepaying the original debt instrument and negotiating new terms. Under many debt agreements, such a prepayment often involves the borrower paying a penalty to compensate the lender for lost interest under the original terms. However, in some cases, it is possible to prepay the original debt without penalty.

Issue 3 did not include any consideration of prepayment penalties.

View 4A – Unchanged, the clarification still applies.

Similar to View 3B, there is no explicit scope exclusion for modifications of financial liabilities with floating interest rates. Therefore, the guidance should be applied, although there may be different approaches to calculating the modification gain or loss.

View 4B – Changed, the clarification would not apply.

Proponents of this view think that the clarification does not apply to situations when there is only a floating rate component to the contractual interest rate (View 2A). Given there is no prepayment penalty, the instrument is akin to one that resets periodically to market rates. The borrower can trigger the renegotiation of a new credit spread at any time without penalty. Unlike situations when a penalty must be paid to compensate the lender for a reduction in credit spread, the interest rate on this instrument is truly a floating rate regardless of the credit spread.

Proponents of this view may also think that the clarification would not apply when there is no prepayment penalty but that it does apply in cases when prepayment would involve paying a penalty to compensate the lender for lost interest. In the latter case, the fact that a penalty is paid to compensate the lender for the reduction in credit spread means that the instrument behaves more like a fixed rate instrument.

The Group's Discussion

A Group member clarified that in the situation contemplated under Issue 4, the lender is the same before and after the prepayment. A situation in which the entity prepays the original debt instrument and renegotiates a new debt instrument with a different lender is likely an extinguishment of the debt instrument, depending on facts and circumstances.

Group members observed that there are many jurisdictions with debt instruments permitting an entity to prepay without penalty. This issue is being discussed globally, with views held on both sides.

Group members thought that there is still a modification to the debt instrument in the fact pattern and supported the view that the clarification applies even in the absence of a prepayment penalty (View 4A). The rationale is that while the borrower has the right to prepay the debt instrument, the

lender is not contractually obligated to fund the prepayment. Therefore, the renegotiated debt instrument is likely not pursuant to the terms and conditions of the original debt instrument. If the entity concludes that the renegotiated debt instrument is not a substantive modification, the clarification guidance would apply when accounting for the change in terms and conditions.

The Group observed that modifications or exchanges of financial liabilities are prevalent in practice and the accounting treatment can be quite complex. Overall, the Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 16: Capitalization of Costs

At its December 2014 meeting, the Group discussed the issue of clarifying when an asset is capable of operating in the manner intended by management. The AcSB staff shared the Group's discussion with the staff of the IFRS Interpretations Committee given the ongoing international project on the accounting for proceeds and costs of testing on property, plant and equipment. The Group has been following the IFRS Interpretations Committee's deliberations and discussed the project proposals at a few meetings (i.e., May 2016, November 2016 and October 2017).

The AcSB raised this issue and other input from the Group on the project proposals through its October 2017 response letter to the IASB's Exposure Draft, "Property, Plant and Equipment – Proceeds before Intended Use (Proposed amendments to IAS 16)." The AcSB staff is monitoring the outcome of this project and will update the Group on any future developments.

IFRS 3 and IAS 39: Transaction Price Allocation

At the October 2017 meeting, the AcSB staff reported to the Group that the IFRS Interpretations Committee discussed the AcSB's submission on this issue in June 2017 and issued a tentative agenda decision.

The IFRS Interpretations Committee finalized its agenda decision at its November 2017 meeting, noting two possible approaches to accounting for the acquisition of a group of assets. The IFRS Interpretations Committee had not obtained evidence that the outcomes of applying the two approaches would have a material effect on the amounts that entities report. Therefore, the issue has not been added to its agenda. However, the IFRS Interpretations Committee will monitor this matter because the forthcoming amendment to the definition of a business in IFRS 3 *Business Combinations* is likely to increase the population of transactions that constitute the acquisition of a group of assets. The AcSB staff will continue to update the Group on any future developments.

OTHER MATTERS

IASB's Accounting Standards Advisory Forum

The AcSB Chair gave a presentation about the Group to the members of the IASB's Accounting Standards Advisory Forum at its December 2017 meeting. There is growing interest internationally about the work of this Group in part because of the number of topics discussed on implementing the

new revenue, financial instruments and leases standards. The presentation covered the Group's evolution pre- and post-transition to IFRS Standards, its current role in assisting the AcSB in supporting the application in Canada of IFRS Standards, and other operational aspects.

Many national standard-setters saw the benefit in the Group's model given its diverse membership and liked the non-authoritative material produced. Some national standard setters are considering the creation of a similar group in their jurisdiction.

Issues Submission

The Group's Agenda Planning Committee received a submission from an external stakeholder with three questions related to the application of IFRS 16 *Leases*. The Group discussed two of the questions at this meeting (i.e., IFRS 16: Future Lease Payments and IFRS 16: Lessee's Discount Rate). One question was not selected for discussion because it did not meet the Group's agenda criteria. The question relates to applying the retrospective approach in IFRS 16 in a situation in which the original master lease agreement cannot be applied. Since this question is an audit matter relating to materiality, as opposed to IFRS 16 not being clear on the requirements for applying the retrospective approach, the Group did not discuss the question.

U.S. Tax Reform

On December 22, 2017, a number of U.S. tax changes were enacted that would have a significant effect on domestic and multinational entities (e.g., Canadian entities that conduct business in the United States). Most of the tax provisions are effective January 1, 2018, with some having retroactive effects on earlier periods.

Under IAS 12 *Income Taxes*, taxes are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. Given that the provisions were enacted on December 22, 2017, and regardless of the January 1, 2018 effective date, entities with a calendar year-end are required to recognize the effect of tax law changes in their December 31, 2017 financial statements.

Some accounting effects include having to remeasure deferred tax balances at the date of enactment, and recognizing the effect of tax law changes in tax expense, other comprehensive income or equity (depending on what items are driving the change in tax balances).

In response to the tax changes and timing issue, the U.S. Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act* (SAB 118). The Bulletin addresses certain fact patterns when the accounting for income tax effects under U.S. GAAP is incomplete and describes supplemental disclosures that should be included in the financial statements. The SEC staff indicated that it would not object to Foreign Private Issuers reporting under IFRS Standards to apply SAB 118 solely for the purposes of accounting for the effect of the tax law changes under IAS 12.

The U.S. Financial Accounting Standards Board is also discussing a number of accounting issues related to the tax law changes under U.S. GAAP (see the tentative agenda decision issued for that Board's January 10, 2018 meeting).

Stakeholders are reminded that while the U.S. SEC is statutorily responsible for U.S. GAAP and its interpretation for public companies that apply that set of standards, only the IASB has the authority to modify IFRS Standards, and only the IASB and IFRS Interpretations Committee have the authority to interpret IFRS Standards. There are ongoing discussions among the international accounting, auditing and regulatory communities on the accounting for these tax law changes. As such, stakeholders are encouraged to monitor these discussions and be cognizant of the potential effect these tax law changes may have on current year-end and ongoing financial reporting.

Representatives from the Canadian Securities Administrators also noted that under Canadian securities legislation, reporting issuers are required to prepare financial statements using IFRS Standards as issued by the IASB accompanied with an unqualified audit report. As a reminder, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* has guidance that indicates the use of reasonable estimates is an essential part of the preparation of financial statements. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

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