IFRS® Discussion Group

Report on the Public Meeting

October 16, 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.

ITEMS PRESENTED AND DISCUSSED AT THE OCTOBER 16, 2018 MEETING

IFRS 11 and IFRS 16: Identifying the Customer in a Lease Contract for the Use of Assets by a Joint Arrangement

IFRS 11 and IAS 28: Assessing for Joint Control

IFRS 16 and IAS 16: Accounting for Asset Retirement Obligations

IFRS 16: Identifying Separate Lease Components

IFRS 16: Guidance on "Low-value" Leases

IFRS 16: Lessee's Discount Rate

IFRS 2 and IAS 8: Modifications to Performance Conditions

Cryptocurrencies – Employee Benefits

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 2 and IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation and Presentation

IFRS 16 and IAS 38: Cloud Computing Arrangements

Cryptocurrencies

OTHER MATTERS

IASB Discussion Paper: Financial Instruments with Characteristics of Equity

Liabilities in Relation to a Joint Operator's Interest in a Joint Operation

IBOR Reform

PRIVATE SESSION

IASB Document for Comments

ITEMS PRESENTED AND DISCUSSED AT THE OCTOBER MEETING

IFRS 11 and IFRS 16: Identifying the Customer in a Lease Contract for the Use of Assets by a Joint Arrangement

The IFRS Interpretations Committee was asked to clarify the recognition of liabilities by a joint operator in relation to its interest in a joint operation. Specifically, the issue relates to the recognition of liabilities by the lead operator.

The Group considered the fact pattern discussed by the IFRS Interpretations Committee.

Fact Pattern 1

- A number of parties establish a joint arrangement by entering into a joint operating agreement. The joint arrangement is not structured through a separate vehicle, and therefore is classified as a joint operation in accordance with paragraph B16 of IFRS 11 *Joint Arrangements*. Each of the parties is a joint operator as defined in IFRS 11.
- The joint operating agreement sets out the terms upon which the joint operators participate in the activity that is subject to the arrangement. The agreement outlines several aspects, including that one of the joint operators is the lead operator. The lead operator manages the day-to-day activities of the joint operations and enters into contracts with third parties. It also specifies how the joint operators share the assets and liabilities, revenues and expenses, in relation to the joint operation.
- The lead operator enters into a lease, as the sole signatory, for an item of property, plant and equipment to be used as part of the relevant activities of the joint operation throughout the term of the lease. The lead operator is liable for the lease payments to the lessor.
- In accordance with the joint operating agreement, the lead operator also has the right to recover a share of the lease costs from the other joint operators.

Analysis

In its September 2018 IFRIC® Update, the IFRS Interpretations Committee issued a tentative agenda decision, observing that the liabilities a joint operator recognizes include those for which it has primary responsibility. This is based on the requirement in paragraph 20(b) of IFRS 11 that requires a joint operator to identify and recognize both (a) liabilities it incurs in relation to its interest in the joint operation, and (b) its share of any liabilities incurred jointly with other parties to the joint operation.

In addition, identifying the liabilities that a joint operator incurs and those incurred jointly requires an assessment of the terms and conditions in all contractual agreements that relate to the joint operation, including consideration of the laws pertaining to those agreements.

For this fact pattern, the lead operator has a present obligation to pay the lessor the lease payments in full, and consequently would recognize 100 per cent of the lease liability. The IFRS Interpretations Committee also noted that the lead operator has a right to recover its proportion of those lease payments from the other joint operators in accordance with the joint operating agreement.

It is also important to disclose information about a joint operation that is sufficient for a financial statement user to understand the activities of the joint operation and a joint operator's interest in that operation. This disclosure is required in accordance with paragraph 20(a) of IFRS 12 *Disclosure of Interests in Other Entities.*

The Group's Discussion

Group members observed that in practice, the terms and conditions in a joint arrangement can differ widely. As a result, it is important that entities carefully consider their specific facts and circumstances to determine the appropriate accounting. For Fact Pattern 1, the Group acknowledged that it is reasonable for the lead operator to recognize 100 per cent of the lease liability given the limited facts specified in the submission to the IFRS Interpretations Committee.

The Group briefly discussed the possibility of a sublease between the lead operator and the other operators in such a leasing situation. In assessing whether there is a sublease, an entity would need to carefully consider the specific facts and circumstances. For example, an entity should consider whether the lead operator (as the potential sub-lessor) has legal recourse against the other parties in the joint arrangement and whether the lead operator has complete control of the asset to direct its use without input from the other parties to sublease the asset. Therefore, careful analysis of the terms and conditions is needed before a conclusion can be made that there is a sublease. An additional point was made that sometimes not all parties to the joint arrangement have the information to know that a sublease exists. However, lack of information is not a basis for non-recognition if a sublease exists.

In some arrangements, there could be cost recovery provisions as well. A lead operator may have a right of recovery in the joint arrangement that could give rise to an asset, but the timing of when to recognize such an asset is very dependent of facts and circumstances. A Group member noted that even if a sublease is present, it would be inappropriate for the lead operator to offset its right of recovery against the obligation to the lessor. The key point in the tentative agenda decision is that,

based on the fact pattern submitted, the lead operator is still legally obligated to the lessor even if the lead operator fails to recover the lease payments from the other joint operators.

There was also a brief discussion from the lessor's perspective. If the lessor had legal recourse against the other joint operators in the arrangement for any unpaid lease payments, the accounting outcome could be different. An observation was made that variations in the fact pattern could influence the accounting outcome, including the determination of who is the customer in the joint arrangement. Paragraph B11 of IFRS 16 *Leases* considers this point because it describes a situation in which a contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement.

The Group then considered a second fact pattern in which the joint operation is incorporated.

Fact Pattern 2

- Parties X, Y and Z establish joint operation K as an incorporated vehicle with its own legal identity to explore a mineral interest.
- K enters into a two-year contract with Supplier R for the use of a drilling rig. The contract meets the definition of a lease under IFRS 16 *Leases*. All parties to the arrangement jointly make all decisions about when and where to use the rig, as well as geographical targets to test.

Analysis

Paragraph B11 of IFRS 16 states:

> "A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in IFRS 11 *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use."

In this fact pattern, K is the customer because it entered into the contract on its own, and will be considered the lessee in the lease with Supplier R. Since the joint arrangement is a joint operation, each of the joint operators would recognize its share of the right-of-use asset and lease liability as prescribed for joint operations in IFRS 11.

The Group's Discussion

Group members agreed with the above analysis, although observing that incorporated joint operations are not prevalent in Canada. A few Group members noted that when an incorporated entity exists in a joint operation, the joint operators typically cannot contract into a gross entitlement position in accounting for the assets or liabilities of the incorporated joint operation. That said, some joint operating agreements can be very specific in distinguishing the responsibilities each joint operator has with respect to the joint operations' liabilities. Careful analysis is required to support an incorporated entity being accounted for as a joint operation. One Group member commented that in performing such analysis, an entity could first start with the accounting by the incorporated entity (i.e., in this fact pattern, Entity K would account for the right-of-use asset and lease liability). The secondary question is how the various parties in the joint arrangement would account for the

incorporated entity by assessing the terms of the contractual arrangement and other facts and circumstances. Disclosures about an entity's interest in a joint arrangement are particularly important so that financial statement users understand the rights and obligations each party has in a specific situation.

Overall, the Group's discussion raises awareness about this item. The Chair of the Group noted that the staff of the AcSB will be responding to the tentative agenda decision, taking into consideration the Group's discussion. Stakeholders were encouraged to follow the IFRS Interpretations Committee's deliberations relating to the finalization of the tentative agenda decision. No further action was recommended to the AcSB.

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

IFRS 11 and IAS 28: Assessing for Joint Control

Joint control is defined in Appendix A of IFRS 11 *Joint Arrangements* as follows:

> "The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control."

Paragraph 10 of IFRS 11 states that "[i]n a joint arrangement, no single party controls the arrangement. A party with joint control of an arrangement can prevent any of the other parties, or a group of parties, from controlling the arrangement." Paragraph B9 of IFRS 11 then states, in part, that "[t]he requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent."

For example, a contractual arrangement can establish unanimous consent implicitly where the portion of the voting rights needed to make decisions about the relevant activities effectively requires a specified combination of the parties to agree.

The Group discussed the following fact pattern to highlight some of the factors to consider in determining whether the arrangement is within the scope of IFRS 11.

Fact Pattern

- Entity S is incorporated for the purpose to acquire, develop and sell certain renewable assets. All of the relevant activities require 80 per cent vote of the shareholders.
- The five parties involved have the following voting rights: A and B each have 38 per cent of the voting rights in the arrangement, and C, D, and E each have 8 per cent.
- All shareholders actively participate in the shareholders' meetings relating to the proposed asset acquisition and disposition, as well as to approve development budgets for each asset in Entity S.
- The shareholders are not contractually required to act together. However, there is a contractual arrangement that sets out the terms upon which the parties participate in the activity because the relevant activities require 80 per cent vote of the shareholders.

Issue: Is this fact pattern considered a joint arrangement under IFRS 11?

View A – Yes.

Under this view, joint control exists in this fact pattern. With combined voting rights of 76 per cent between A and B, no decisions can be made without the agreement of these two parties. This means that A and B need to participate in all decisions regarding the relevant activities of Entity S. Proponents of this view also think that unanimous consent is implicit because A or B, both individually or together, can prevent any other party from reaching the 80 per cent minimum voting requirement.

View B – No.

Under this view, joint control does not exist in this fact pattern. Paragraph B8 of IFRS 11 states:

> "In other circumstances, the contractual arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement."

The contractual arrangement specifies that 80 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A or B can block any decision because of their individual 38 per cent voting rights, neither A nor B controls the arrangement because each would require the agreement of the other, and also the votes of party C, D, or E. This means there is more than one combination of parties that can reach 80 per cent of the voting rights.

Proponents of this view think that there is not unanimous consent because control is shared amongst A and B, and any one of the other parties (i.e., C, D, or E). To be a joint arrangement, the contractual arrangement among the parties would need to indicate which specific combination of the parties is required to agree unanimously to decisions about the relevant activities in the arrangement.

View C – It depends on the facts and circumstances.

Paragraph 12 of IFRS 11 indicates that an entity will need to make an assessment of whether all, or a group, of the parties have control of the arrangement based on considering all the facts and circumstances.

The Group's Discussion

Group members noted that this fact pattern is not considered a joint arrangement under IFRS 11 for the reasons described in View B above. The guidance in IFRS 11 is quite explicit such that View A and View C are not supportable. A Group member noted that this fact pattern is fundamentally similar to Example 2 in paragraph B8 of IFRS 11. Another Group member analyzed the fact pattern from a different perspective, noting that typically if one of two parties, each with joint control to a joint arrangement, sells its interest to the other party with joint control, the other party itself would obtain full control. However, in applying this logic to the fact pattern presented, if A were to sell its

interest to B, B would still not have control of the arrangement because it would need C, D or E to make decisions about the relevant activities.

A question was raised as to the economics behind such a fact pattern. A few Group members observed that this fact pattern is common in practice because the voting structure provides protection to the minority shareholders. That said, it is important to remember that in assessing for control or joint control, the ability to block decisions is not the only factor taken into account. Rather, control requires the unilateral ability to make decisions about the relevant activities in the arrangement either by a single party, or jointly together through one specific combination of the parties involved.

The Group's discussion raises awareness about the factors to consider in assessing for joint control. 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 16: Accounting for Asset Retirement Obligations

In many cases, a lessee will enter into a lease agreement to rent space from a lessor. The lease agreement specifies that the lessee has an obligation at the end of the lease term, to remove the item of property, plant and equipment which the lessee installs on the premises (e.g., leasehold improvements or immovable equipment).

Under IAS 17 *Leases*, operating leases are not recognized in the Statement of Financial Position. Therefore, entities have in practice, recognized the corresponding costs associated with the asset retirement obligation as part of the item of property, plant and equipment in accordance with paragraph 16(c) of IAS 16 *Property, Plant and Equipment*.

The Group discussed two fact patterns to highlight factors a lessee should consider regarding the recognition of costs associated with an asset retirement obligation on the adoption of IFRS 16 *Leases*.

Fact Pattern 1

- On January 1, 2020, Entity A enters into a 10-year lease agreement for the lease of land and installs equipment on the land. The lessee constructs a concrete base to support and attach equipment to the land (i.e., the equipment is effectively immoveable).
- Under the terms and conditions of the lease agreement, the lessee is required to remove the equipment and restore the land back to its original condition at the end of the lease term. The lessee determines that a liability for restoration should be recognized under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- The agreement to rent the land qualifies as a lease as defined in IFRS 16. Entity A recognizes a liability for its obligation to remove the attached equipment and restore the land to its original condition when it incurs the obligation (i.e. the equipment is installed or attached to the land).

Issue 1: Should the lessee account for the costs of removing the equipment and restoring the leased land as part of (1) the cost of the right-of-use asset or (2) the cost of the item of property, plant and equipment?

View 1A – Account for the costs as part of the right-of-use asset.

Proponents of this view consider that the obligation falls within the scope of paragraph 24(d) of IFRS 16, which states, in part, that the cost of the right-of-use asset shall comprise:

> "an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories."

The costs of removing the equipment and restoring the land would not be incurred absent the lease agreement. Therefore, they should be recognized as part of the right-of-use asset.

View 1B – Account for the costs as part of the item of property, plant and equipment.

Proponents of this view consider that the obligation falls within the scope of paragraph 16(c) of IAS 16, which states, that the cost of an item of property, plant and equipment comprises:

> "the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

Paragraph 24(d) of IFRS 16 does not apply because the obligation is not in respect of the leased property, but rather it is an obligation triggered by the installation and construction of the lessee's own assets on the leased property.

View 1C – There is an accounting policy choice.

Proponents of this view think that the guidance is unclear as to whether the costs should be attributable to the right-of-use asset or the cost of the item of property, plant and equipment. As a result, entities can establish an accounting policy and apply it consistently to all similar arrangements.

The Group's Discussion

Group members expressed diverse views on this issue.

Some Group members supported View 1A because it is the lease contract that gives rise to the removal obligation. This means that the entity is required to restore the land back to its original condition because of the terms and conditions of the lease. Therefore, the costs of removing the equipment should be part of the right-of-use asset.

Other Group members supported View 1B on the basis that the lease contract does not require the installation of the equipment. The decision to install the equipment either at commencement of the lease term, or thereafter, relates to the newly installed asset. The new asset is not specifically tied to the right-of-use asset that is associated with the lease arrangement. Therefore, the obligation to

remove the new asset should be part of the cost of the new asset (i.e., the item of property, plant and equipment).

A Group member noted that paragraph 24(d) of IFRS 16 replicates paragraph 16(c) of IAS 16. Generally under IAS 16, costs to dismantle and remove the item and restore the site on which the item is located are capitalized to the item of property, plant and equipment on initial acquisition. As the equipment was installed after initial recognition of the right-of-use-asset in the lease, this would suggest that those costs relate to the new asset installed rather than the right-of-use asset. This line of thinking would support View 1B. However, suppose an entity removed something from the leased premises and had an obligation to restore the premises before the end of the lease term. In that situation, there is only the right-of-use asset and a related restoration obligation. Since there is no new asset installed, capitalizing the restoration costs as part of the right-of-use asset may be more appropriate.

In light of the points raised above, some Group members supported that an accounting policy choice is acceptable (View 1C). Neither View 1A nor View 1B can be rejected based on how the existing guidance is currently worded in IFRS Standards.

A clarifying point was made during the Group's discussions that regardless of which view an entity adopts, the liability side of the restoration costs are accounted for under IAS 37. The lease liability is accounted for under IFRS 16. This means that neither View 1A nor View 1B affects the accounting for the restoration costs liability. However, there is a classification impact on the Statement of Financial Position. There could also be a related profit or loss impact in calculating depreciation expense if the restoration costs are capitalized as part of the item of property, plant and equipment, or the right-of-use asset depending on specific facts and circumstances.

Fact Pattern 2

- Prior to the adoption of IFRS 16, Entity B (lessee) had entered into agreements to lease premises. The lessee installed leasehold improvements or immovable equipment on the leased premises.
- Under the terms and conditions of the lease agreement, the lessee is required to remove the leasehold improvements or immovable equipment and restore the leased premises back to its original condition at the end of the lease term.
- The leases were classified as operating leases under IAS 17. Entity B recognized an obligation to remove the leasehold improvements or immovable equipment as a liability in accordance with IAS 37 at the time the assets were installed. The offsetting debit was recognized as part of the cost of item of property, plant and equipment in accordance with paragraph 16 of IAS 16.
- Assume Entity B will account for restoration costs incurred after the adoption of IFRS 16 by applying View 1A above (i.e., as part of the right-of-use asset).

Issue 2: How should Entity B account for the restoration costs in respect of operating leases that are capitalized to the item of property, plant and equipment, on the adoption of IFRS 16?

The Group discussed Issue 2 by considering each of the transition methods available in paragraph C5 of IFRS 16. The transition methods are:

(a) retrospectively with the prior period restated for the effects of IFRS 16 (also referred to as the full retrospective method); or

(b) retrospectively with the cumulative effect of initially apply the standard recognized at the date of initial application (also referred to as the modified retrospective method).

If View 1B were applied (i.e., restoration costs recognized as part of the item of property, plant and equipment), there would be no change to the existing accounting under the full retrospective or the modified retrospective method when adopting IFRS 16. The entity would carry forward the carrying amount of the restoration costs in the item of property, plant and equipment on transition to IFRS 16.

Issue 2.1: If Entity B applies the full retrospective method, how would it measure the right-of-use asset?

Analysis

Under the full retrospective method, an entity measures the right-of-use asset as if IFRS 16 had always been applied. The restoration costs that are included in the right-of-use asset are the amounts equal to the restoration liability under IAS 37 at the lease commencement date.

Subsequent to the commencement date, the entity accounts for depreciation and any other events that affect the carrying amount of the right-of-use asset in accordance with IFRS 16.

Since Entity B recognized the restoration costs as part of the item of property, plant and equipment under IAS 16, it would derecognize such amounts. Any differences between the carrying amount of the restoration costs capitalized to the right-of-use asset, and the carrying amount derecognized from the item of property, plant and equipment would be recognized as an adjustment to retained earnings at the beginning of the earliest period presented.

If Entity B does not apply the full retrospective method, it has two options to measure the right-of-use asset at the date of initial application under the modified retrospective method. The two options are described in paragraphs C8(b)(i) and C8(b)(ii) of IFRS 16 (see Issues 2.2 and 2.3 respectively).

The Group's Discussion

The Group's discussion of Issue 2.1 presumes that the entity's accounting policy is to recognize the restoration costs as part of the right-of-use asset (View 1A). Group members who commented agreed with the above analysis. However, several Group members noted that they did not see View 1A as the only answer for Issue 1, and thought the accounting is complex as a result of having subscribed to View 1A.

Issue 2.2: How should Entity B measure the right-of-use asset under the modified retrospective method in paragraph C8(b)(i) of IFRS 16, whereby the right-of-use asset before discounting is measured in the same way as the full retrospective method (subject to any practical expedients that Entity B elects to apply)?

View 2.2A – The right-of-use asset is measured at its carrying amount as if IFRS 16 had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application.

Proponents of this view consider that by applying C8(b)(i) of IFRS 16, the right-of-use asset would be measured in a similar way as described under the full retrospective method (subject to any practical expedients the lessee elects to apply in accordance with paragraph C10 of IFRS 16), except for the discount rate. However, any differences between the carrying amount of the restoration costs capitalized to the right-of-use asset and the carrying amount derecognized from the item of property, plant and equipment, would be recognized as an adjustment to retained earnings at the date of initial application.

The practical expedients available under the modified retrospective method in paragraph C10 of IFRS 16 do not provide any relief in the context of restoration costs. The relief using the lessee's incremental borrowing rate at the date of initial application does not affect the asset retirement obligation since the restoration costs are measured and discounted under IAS 37, and not IFRS 16.

View 2.2B – Entity B should recreate the right-of-use asset for the component relating to the lease payments, but retain the carrying amount of the restoration costs in the item of property, plant and equipment.

Proponents of this view consider that C8(b)(i) of IFRS 16 does not address how to account for restoration costs that are already recognized as part of the item of property, plant and equipment under IAS 16. Therefore, the standard does not preclude carrying forward the carrying amount of those restoration costs as part of the item of property, plant and equipment.

Entity B could elect several practical expedients under paragraph C10 of IFRS 16. The result is that the right-of-use asset will not necessarily be equal to that determined under the full retrospective method.

The Group's Discussion

Group members who expressed a view thought that measuring the right-of-use asset would be similar to the full retrospective approach, with the exception of using the incremental borrowing rate at the date of initial application (View 2.2A). Again, this view is based on the fact that the entity has subscribed to View 1A for Issue 1 of recognizing restoration costs as part of the right-of-use asset.

Issue 2.3: If Entity B applies paragraph C8(b)(ii) of IFRS 16, how should it treat the carrying amount of the existing restoration costs on transition to IFRS 16?

Paragraph C8(b)(ii) of IFRS 16 indicates that the lessee will choose, on a lease-by-lease basis, to measure the right-of-use asset as "an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application."

View 2.3A – Entity B should carry forward the carrying amount of restoration costs in the item of property, plant and equipment.

Based on paragraph C8(b)(ii) of IFRS 16, the entity should retain the carrying amount of the restoration costs in the item of property, plant and equipment. Restoration costs are not part of the lease liability or one of the adjustments described in this paragraph.

View 2.3B – Entity B should derecognize the carrying amount of the restoration costs in the item of property, plant and equipment.

Proponents of this view note that paragraph C8(b)(ii) of IFRS 16 deems the opening balance of the right-of-use asset on transition to be equal to the lease liability. Therefore, the existing carrying amount of restoration costs in the item of property, plant and equipment should be derecognized and recognized as an adjustment to retained earnings upon transition to IFRS 16.

View 2.3C – Entity B should transfer the existing carrying amount of restoration costs into the right-of-use asset.

Under this view, restoration costs are considered analogous to a "prepaid lease payment" which are included as an adjustment at their existing carrying value to the lease liability when calculating the right-of-use asset under paragraph C8(b)(ii) of IFRS 16.

The Group's Discussion

Group members expressed diverse views on this issue.

Some Group members expressed support for consistency in accounting treatments between transition and the ongoing post-IFRS 16 accounting policy. If an entity's accounting policy is to recognize the restoration costs as part of the right-of-use asset, there is a lack of consistency if restoration costs are left as part of the item of property, plant and equipment on transition to IFRS 16. Therefore, transferring the existing carrying amounts of the restoration costs to the right-of-use asset (View 2.3C) seems more reasonable than leaving the costs as part of the item of property, plant and equipment (View 2.3A).

A few Group members who also supported consistent accounting treatment thought it would be difficult to preclude writing off the restoration cost at the date of initial application given the ambiguity in the transition guidance. However, other Group members expressed concerns with derecognizing the carrying amount of the restoration costs in the item of property, plant and equipment (View 2.3B). By doing so, there is no value ascribed on the asset side of the balance sheet to the asset retirement obligation.

Several other Group members found it challenging to rule out any specific views given the different view points expressed. One Group member also thought that the lack of transition guidance on Issue 2.3 in IFRS 16 could suggest that View 1B was the intended view for Issue 1 (i.e., restoration costs are part of the cost of an item of property, plant and equipment). However, another Group member thought silence in IFRS Standards should not be read as implying a specific answer.

The Group recognized that Issues 2.1 to 2.3, which are all transition related, are predicated on gaining clarity around whether, after adoption of IFRS 16, the lessee should account for the costs of

removing the equipment and restoring the leased land as part of the right-of-use asset or the item of property, plant and equipment (i.e., Issue 1). The Group also acknowledged that there is a timing challenge in bringing clarity to the transition issues given the near effective date of IFRS 16. As a result, depending on the significance, it may be important that an entity discloses its accounting policy in respect of how it measures its right-of-use asset or item of property, plant and equipment when it comes to accounting for restoration costs related to a leasing arrangement.

A representative of the Canadian Securities Administrators noted that there would be benefit to clarifying Issue 1 since this particular issue continues after adoption of IFRS 16. If new information were to arise that clarifies what is required by IFRS 16, then guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in accounting for the change should be considered.

Overall, the Group recommended that these issues, in particular Issue 1, be discussed with the AcSB to determine what further action can be taken to bring clarity to stakeholders. The AcSB will discuss the issue at its November 2018 meeting.

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

IFRS 16: Identifying Separate Lease Components

When a lease includes both land and building elements, a lessee is required to apply the guidance in paragraph 12 of IFRS 16 *Leases* to determine whether the right-to-use the land and building are a single lease component or separate lease components.

Paragraph B32 of IFRS 16 provides the criteria for determining whether the right to use an underlying asset is a separate lease component. The criteria are:

1) the lessee can benefit from the use of the underlying asset on its own or together with other readily available resources; and

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

If an entity elects to adopt IFRS 16 retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application (i.e., using the modified retrospective method), the entity applies the transitional guidance for leases that were previously operating leases or finance leases under IAS 17 *Leases*.

The Group discussed the following two fact patterns and considered four issues relating to identifying separate lease components in a lease contract involving a land and building elements.

Fact Pattern 1

- An entity entered into a lease of real property comprised of a building and land on which the building resides. The building cannot be relocated, nor can a second building be constructed on the land.
- The lessee operates a retail store in the leased building.
- There are no non-lease components payable to the lessor in the lease contract.

Issue 1: Are the building and the land considered separate lease components under IFRS 16?

View 1A – No.

Proponents of this view note that the criteria in paragraph B32 of IFRS 16 are not met because the lessee cannot benefit from the building without the land on which it resides, and the lessee cannot replace the land or building with readily available resources.

View 1B – Yes.

Proponents of this view look to the explicit guidance in U.S. GAAP on this matter. Accounting Standards Codification paragraph 842-10-15-29 states:

> "The guidance in paragraph 842-10-15-28 notwithstanding, to classify and account for a lease of land and other assets, an entity shall account for the right to use land as a separate lease component unless the accounting effect of doing so would be insignificant (for example, separating the land element would have no effect on lease classification of any lease component or the amount recognized for the land lease component would be insignificant)."

The guidance in U.S. GAAP suggests that land is a separate lease component. However, whether the land should be accounted for separately would depend on if the accounting effect is significant.

The Group's Discussion

For this fact pattern, Group members noted that the building and the land are not considered separate lease components because they are used as one element (View 1A). One Group member noted that it would be inappropriate to look to U.S. GAAP, because the guidance in this area is different compared to IFRS Standards.

Issue 2: Assume that the lease also included an adjacent parking lot to be used exclusively by the entity's customers. Are the building and adjacent parking lot considered separate lease components under IFRS 16?

View 2A – No.

Under this view, the building and the parking lot <u>are</u> highly dependent on, or highly interrelated with each other. Without the store, there would be no need for the parking lot. Vice versa, the parking lot gives customers access to the store.

View 2B – Yes.

Under this view, the building and the parking lot <u>are not</u> highly dependent on, nor highly inter-related with each other. For example, the building can be rented out to a third party. Also, not all customers require parking, or they could find alternative parking nearby. This means that the lessee's right to use one of the underlying assets would not be affected by the removal of the other underlying asset in the arrangement.

The Group's Discussion

Some Group members thought that the building and parking lot are considered separate lease components (View 2A), while others did not (View 2B). The facts and circumstances would affect the judgment applied in making the determination of whether separate lease components exist. In making this judgment, an entity should consider certain factors. For example, does the parking lot generate its own revenue stream, does the lease agreement refer to the building and parking lot as separate items and is the building in a location where customers can access it without driving to the parking lot? Group members found it difficult to preclude either view. One Group member observed that if the amortization periods were the same for both the building and parking lot, there may not be a material effect on the financial statements irrespective of whether they are considered separate lease components.

Issue 3: Paragraph C3 of IFRS 16 is a practical expedient that allows a lessee to not reassess whether a contract is a lease or contains a lease on adoption of IFRS 16. Assuming that the lessee elected to apply this practical expedient, is the lessee required to assess whether the lease contains separate lease components on transition to IFRS 16?

View 3A – Yes.

Proponents of this view think that the lessee would be required to apply paragraph B32 of IFRS 16, (i.e., the criteria for identifying separate lease components) because the standard does not provide transitional relief for a lessee from performing this assessment.

View 3B – No.

Proponents of this view rely on the fact that the practical expedient in paragraph C3 of IFRS 16 does not require a lessee to reassess whether a contract is a lease or contains a lease on adoption of IFRS 16. Therefore, by extension, a lessee would not need to look within a contract that is a lease for separate lease components.

The Group's Discussion

Group members supported the view that a lessee is required to assess whether the lease contains separate lease components on transition to IFRS 16 (View 3A). The reason is that the practical expedient in paragraph C3 of IFRS 16 is meant to address only the assessment on adoption of IFRS 16 of whether there is a lease. Therefore, an entity is required to apply paragraph B32 of IFRS 16 to identify separate lease components.

Fact Pattern 2

In 2001, a lessee entered into a lease for land and building. In accordance with IAS 17, the lessee concluded that the land component of the lease was an operating lease, and the building component was a finance lease.

In accordance with View 3A for Issue 3, assume that the lessee determined upon transition to IFRS 16 that the land and building are a single lease component by applying paragraph B32 of IFRS 16 (i.e., View 1A under Issue 1). The lessee also adopted the modified retrospective approach for applying IFRS 16.

Issue 4: Given the lessee concluded that the land and building are a single lease component on transition to IFRS 16, how would the lessee apply the transition guidance in IFRS 16?

Paragraphs C8 to C12 of IFRS 16 provide transitional guidance for a lessee that has adopted the modified retrospective approach.

View 4A – Apply the transitional guidance for operating leases to the single lease component (i.e., the land and the building).

Under this view, paragraph C11 of IFRS 16 requires the lessee to account for the right-of-use asset and the lease liability for finance leases under IAS 17 from the date of initial application. However, as the lessee determined that the land and building are a single lease component and not considered a finance lease under IAS 17, the entity would apply the transitional guidance for operating leases.

View 4B – Apply the transitional guidance for operating leases to the land, and the transitional guidance for finance leases to the building.

Under this view, the lessee would recognize the right-of-use asset and lease liability for the land, measured in accordance with paragraphs C8 to C10 of IFRS 16. The lessee would carry forward the carrying amount of the right-of-use asset and lease liability computed under IAS 17 for the building on the date of initial application in accordance with C11 of IFRS 16.

Proponents of this view think that applying "the Standard from the date of initial application" should not unwind the accounting prescribed for finance leases (i.e., carrying forward existing balances). This requirement applies to subsequent measurement only. The lessee would have two separate discount rates – the rate determined at the commencement date of the finance lease and the rate determined at the date of initial application for the operating lease.

View 4C – An accounting policy choice exists.

Proponents of this view think that IFRS Standards are not specific on this point, and therefore, an accounting policy choice exists on the adoption of IFRS 16.

The Group's Discussion

A majority of the Group members supported that an accounting policy choice exists because it was difficult to preclude either of the other two views (View 4C).

Some Group members thought that View 4A is supportable because an entity first applies IFRS 16 to determine whether the land and building are a single lease component. For that single lease component, the entity then determines that there is no finance lease at the date of initial application. Therefore, transition paragraph C11 of IFRS 16 would not apply and so by default, the transition guidance for leases previously classified as operating leases would apply.

Other Group members noted there is some rationale to View 4B because under IAS 17, the entity had an operating and a financing lease and there is different transition guidance written for each type of lease. As a result, Group members found it difficult to rule out any view but noted that this is an issue only on transition to IFRS 16.

Overall, the Group's discussion raises awareness about the considerations involved around identifying separate lease components and some of the complexities in applying the transition guidance. 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: Guidance on "Low-value" Leases

Based on the recognition exemption in paragraph 5 of IFRS 16 *Leases*, a lessee can elect not to recognize a right-of-use asset and a lease liability for leases for which the underlying asset is of low value. The value of an underlying asset is based on the value of the asset when it is new, regardless of the age of the asset being leased. This election can be made on a lease-by-lease basis. If a lessee applies the recognition exemption, the lease payments are recognized as an expense on either a straight-line basis over the lease term or another systematic basis.

Paragraphs B3-B8 of IFRS 16 provide application guidance for this recognition exemption, including examples of underlying assets of low value, such as tablets and personal computers, small items of office furniture and telephones. However, the application guidance does not explicitly quantify what is meant by a "low value" asset. Instead, paragraph B5 of IFRS 16 states:

> "An underlying asset can be of low value only if:
>
> (a) the lessee can benefit from 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 not highly dependent on, or highly interrelated with, other assets."

Paragraph BC100 in the Basis for Conclusions on IFRS 16 does indicate that when the IASB decided on the exemption, it had in mind leases of underlying assets with a value, when new, in the order of magnitude of US$5,000 or less.

The Group discussed the following fact pattern to highlight factors to consider when assessing whether a leased asset may qualify for the low-value recognition exemption.

Fact Pattern

An entity has the following leases:

- Leases of buildings;
- Leases of vehicles (each individual asset is worth significantly more than US$5,000 when new);
- Leases of office furniture (each individual asset is worth CAD$7,000 (US$5,300) when new); and
- Leases of IT equipment such as a lease arrangement for 100 laptops (each individual laptop is worth CAD$1,000 when new, for a total lease value of CAD$100,000).

Issue: Which leased assets qualify for the low-value exemption?

View A – Leases of office furniture and IT equipment.

Proponents of this view note that IFRS 16 does not provide an explicit quantification for what is a low-value asset. Although the Basis for Conclusions on IFRS 16 mentions that the IASB had in mind a magnitude of US$5,000 or less, this amount is not considered a bright-line test. Therefore, the leases of office furniture are considered to be of sufficient low-value to qualify for the exemption despite the value of each asset being above US$5,000.

Proponents of this view also note that the recognition exemption can be applied on a lease-by-lease basis, subject to the interdependence condition in paragraph B5 of IFRS 16. An entity is not required to aggregate the leases to determine if the overall effect is material. In the case of the leases of IT equipment, while the total assets under the lease arrangement are worth CAD$100,000 when new, each laptop is worth only CAD$1,000 when new, and therefore, qualifies for the low-value lease exemption.

For the leases of buildings and leases of vehicles, those underlying assets, when new, are significantly above US$5,000. As a result, the recognition and measurement requirements of IFRS 16 apply.

View B – Leases of IT equipment only.

This view is similar to View A, except for the perspective on whether US$5,000 is considered a bright-line test.

Proponents of this view think that while IFRS 16 does not provide an explicit quantification of what is considered a low-value asset, paragraph BC100 in the Basis for Conclusions implies a threshold, or a bright-line test, of US$5,000 or less. Therefore, the leases of office furniture would not qualify for the recognition exemption on the basis that the underlying assets, when new, are individually over the threshold of US$5,000 at the inception of the lease.

View C – Leases of office furniture only.

This view is similar to View A, except for the perspective of how the "lease-by-lease basis" guidance is applied.

Proponents of this view acknowledge that the recognition exemption can be applied on a lease-by-lease basis and is subject to the interdependence requirement in paragraph B5 of IFRS 16. However, in the case of the leases of IT equipment, each leased asset is part of an overall lease arrangement. The total assets under that one lease arrangement are worth CAD$100,000 when new and would not be considered to qualify for the low-value lease recognition exemption.

View D – No leases qualify for the exemption.

Proponents of this view share the same perspective outlined in View A for the leases of buildings and vehicles, View B for leases of office furniture, and View C for leases of IT equipment.

The Group's Discussion

A substantial majority of the Group members supported the view that leases of office furniture and IT equipment would qualify for the low-value exemption in IFRS 16 (View A).

Group members noted that the amount of US$5,000 referred to in paragraph BC100 in the Basis for Conclusions on IFRS 16 is not intended to be a bright-line test. Entities are required to apply judgment when applying the recognition exemption to leases for which the underlying asset is of low value. Group members also noted that while the recognition exemption is not a materiality assessment, materiality may come into play when applying this exemption in IFRS 16.

Some Group members observed that in practice, entities leverage their existing asset capitalization policy in determining what constitutes low-value leased assets. However, a point was made that by not recognizing a leased asset, there is also a potential for understating the entity's liabilities as well. This effect on the entity's financial position is different compared to the decision for not capitalizing items of property, plant and equipment. Therefore, entities should make sure the effect of not recognizing low-value leased assets is considered from both asset and liability perspectives as there could be covenant and financial liquidity implications.

In addition, entities are required to disclose the expense relating to leases of low-value assets, so it is important to have a system in place to track this data. A representative of the Canadian Securities Administrators noted that this disclosure is an important indicator as to how judgment is applied in determining what the entity considers to be low value.

The Group's discussion raises awareness about the judgments involved when applying the recognition exemption to leases for which the underlying asset is of low value. 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

At its January 2018 meeting, the Group discussed whether an entity should use an interest rate that reflects the original term of the lease, or the remaining term of the lease, at the date of initial application when applying paragraph C8(a) of IFRS 16 *Leases* to measure the lease liability. The Group agreed that the transition guidance in IFRS 16 does not explicitly address this point.

At this meeting, the Group first discussed a related transition question with respect to measuring the right-of-use asset (Issue 1).

Issue 1: An entity has elected to measure the right-of-use asset by applying paragraph C8(b)(i) of IFRS 16. Upon initial adoption of IFRS 16, should the lessee measure the right-of-use asset using the same incremental borrowing rate that was used to measure the lease liability? Alternatively, can the lessee choose to use a rate reflective of the original lease term, even if it measured the lease liability using the remaining lease term?

Paragraph C8(b)(i) of IFRS 16 provides guidance on the recognition of a right-of-use asset at the date of initial application for leases previously classified as an operating lease under IAS 17 *Leases.* The paragraph allows a lessee to measure the right-of-use asset at "its carrying amount as if the

Standard has been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application."

View 1A – The right-of-use asset and lease liability should be measured using the same incremental borrowing rate.

Proponents of this view note that both paragraphs C8(a) and C8(b)(i) of IFRS 16 have identical terminology when referring to discounting using the lessee's incremental borrowing rate at the date of initial application. Therefore, the same rate should be applied both to discounting the lease liability and the right-of-use asset.

Another consideration is that IFRS 16 intends for a single discount rate to be used for a new lease entered into subsequent to transition. If the right-of-use asset was measured independently from the lease liability, anomalous results would be produced.

View 1B – The right-of-use asset and lease liability may be measured using an incremental borrowing rate reflective of different lease terms.

Proponents of this view note that paragraph C8(b) of IFRS 16 states that the lessee shall choose, "on a lease-by-lease basis", between the two options to measure the right-of-use asset. The availability of such a choice supports the view that a consistent approach is not needed when determining the incremental borrowing rate to be applied to the lease liability and the right-of-use asset.

The lease payments included in each of the options provided in paragraph C8(b) of IFRS 16 can be viewed as a better indicator of the term to consider when determining the incremental borrowing rate. Furthermore, paragraph C8(b)(i) of IFRS 16 refers to measuring the right-of-use asset "as if the Standard had been applied since the commencement date," which implies that the lease payments for the original lease term will be included. It seems inconsistent to then discount these cash flows using a rate that is reflective of the remaining lease term.

The Group's Discussion

Group members supported that the right-of-use asset and lease liability should be measured using the same incremental borrowing rate based on what is described in View 1A. The foundation of IFRS 16 requires consistency in measuring the right-of-use asset and lease liability.

The Group then discussed other considerations an entity should take into account when determining its incremental borrowing rate (Issue 2). The following are three sub-issues under this area which the Group considered together.

Issue 2.1: Can a lessee use the rate on its existing borrowings as its incremental borrowing rate?

Analysis

IFRS 16 defines a lessee's incremental borrowing rate as "[t]he 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."

As a result, there are many factors to consider in determining the lessee's incremental borrowing rate (e.g., credit quality, term and payment pattern, the security including collateralization by the underlying right-of-use asset, the borrowing rate to obtain an asset of similar value, and the economic environment).

The incremental borrowing rate must take into account the terms and conditions of the specific lease contract. Therefore, the lessee's rate on its existing borrowings may be a starting point, but it is likely adjustments will need to be made.

The following are some factors to consider when determining the need for an adjustment to the existing borrowing rates:

- The entity entered into its borrowings at a different point in time compared to the specific lease contract.
- The lessee's indebtedness level may change from entering into a new lease that would affect the rate at which the entity can borrow going forward.
- Yields on existing borrowings or credit facilities may not reflect a similar term as the specific lease contract, or reflect similar security compared with the lease arrangement where only the right-of-use asset may be used as collateral.
- Existing borrowings might contain embedded put or call options which affect the coupon rate.

Issue 2.2: May a subsidiary use its parent's incremental borrowing rate?

Analysis

A group of entities may have a centralized treasury function that the parent entity maintains. The subsidiary may not have its own external borrowings but it cannot default to using its parent entity's incremental borrowing rate because IFRS 16 requires the incremental borrowing rate to be specific to the lessee. Instead, the parent entity's incremental borrowing rate could be a starting point, but adjusted to reflect any differences in the subsidiary's credit profile. Such adjustments may be mitigated if there is a parent guarantee in place of the subsidiary's lease payments.

A foreign subsidiary needs to consider its economic environment, including whether its leases are denominated in a different currency. Also, a subsidiary may borrow from its parent at an intra-group rate. An adjustment may be required if the intra-group rate does not reflect market rates based on the subsidiary's credit profile.

In addition, considerations for other adjustments to the rate are similar to those described in Issue 2.1.

Issue 2.3: As stated in the definition of the incremental borrowing rate, how should a lessee interpret the phrase "pay to borrow over a similar term" when determining the appropriate incremental borrowing rate?

Analysis

Although IFRS 16 is not explicit as to how the phrase "similar term" should be interpreted, the duration over which the payments are made and the frequency of payments should be considered to achieve an incremental borrowing rate truly reflective of lease-specific characteristics.

The risks associated with an arrangement with frequent periodic payments of principal and interest (i.e., amortizing loan) are different from arrangements with a single principal payment at maturity (i.e., non-amortizing loan). Holding all other factors constant, a rate for a loan with repayment of principal only at maturity will often be higher than one that assumes monthly principal and interest payments throughout the duration of the loan. Therefore, this determination could have a significant impact on the measurement of the lease liability and right-of-use asset.

The Group's Discussion

Several Group members shared insights and experiences relating to Issues 2.1 to 2.3.

For a situation in which the lessee is a subsidiary and there is a centralized treasury function, the challenge is to adjust the corporate borrowing rate to a lessee and asset specific rate. Generally, this process would involve discussions with the treasury department to come up with a rate that is supportable and auditable. This process could result in identifying a range of reasonable rates and entities would need to apply judgment to determine which rate is most appropriate for the specific lease contract. It is also important to assess holistically whether all the adjustments made to the corporate borrowing rate are reasonable. One way of doing so could be looking at the rates in recently signed lease contracts to see if they align with the adjusted borrowing rate.

Group members also noted there are other factors that could affect the type of adjustments needed to a lessee's rate on its existing borrowings. For example, an entity needs to take into account the length of the lease, the nature and quality of the collateral provided and the economic environment in which the lease contract originates. These factors can be different when compared to existing borrowing arrangements of the entity. Further, some entities like smaller reporting issuers may not have other borrowings outstanding to use as a point of reference.

Although IFRS 16 is clear that the lessee's incremental borrowing rate must take into account the terms and conditions of the specific lease contract, a level of aggregation may be required to practically implement the standard. An analogy was made to determining different depreciation rates for categories of property, plant and equipment. Also, depending on the magnitude of the leases, there could be significant judgments involved in deciding the appropriate adjustments to a lessee's existing borrowing rate. As a result, an entity should consider whether it has provided adequate disclosures for financial statement users to understand the significant judgments applied in coming up with a reasonable incremental borrowing rate that is specific to a material lease, or group of material leases.

Overall, the Group's discussion raises awareness around what entities should consider when determining the incremental borrowing rate. No further recommendation was made to the AcSB.

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

IFRS 2 and IAS 8: Modifications to Performance Conditions

Many entities include non-market performance conditions in their share-based payment arrangements. A non-market performance condition might be an EBITDA (earnings before interest, tax, depreciation and amortization) target required to be met for the award to vest. However, the adoption of a new accounting standard may bring into question whether the non-market

performance conditions are still appropriate given the effect the new accounting standard would have on such conditions. For example:

(a) Net income may decrease under IFRS 9 *Financial Instruments* when applying the expected loss model for certain financial assets.

(b) The timing of revenue recognition may be earlier or later under IFRS 15 *Revenue from Contracts with Customers*.

(c) EBITDA may increase subsequent to the adoption of IFRS 16 *Leases.*

Entities may decide to modify their share-based payment arrangements to take into consideration the effect of the new accounting standard. For example, an entity might increase the EBITDA target to ensure such target considers the effect of adopting IFRS 16. The accounting for modifications to share-based payment arrangements under IFRS 2 *Share-based Payment,* depends upon whether the modification increases the fair value of the share-based payment award or is otherwise beneficial to the employee.

The Group discussed the fact pattern below to highlight how entities should determine whether a modification to a non-market performance condition is beneficial when management changes the plan because of a change in accounting policy.

Fact Pattern

January 1, 201X	• 10,000 share options granted • Receipt of the award is conditional upon: ○ the recipient remaining in employment for 3 years; and ○ the entity achieving cumulative EBITDA exceeding CU1,000 over the 3-year period.[1]
July 14, 201X	The entity determines that cumulative EBITDA will be increased by approximately CU300 due to the adoption of a new accounting standard.
December 14, 201X	The Board of Directors approve of a share options modification to increase the cumulative EBITDA target to CU1,300.
January 1, 201Y	The entity adopts a new accounting standard.

The share-based payment arrangement does not specify how a change in the non-market performance condition due to a change in an accounting standard is applied.

[1] This vesting condition is the “non-market performance condition”.

Issue 1: If the share-based payment arrangement specified how to account for a change in non-performance market condition, is there a modification to the plan?

Analysis

There is no modification to the plan if the share-based payment arrangement specified how to apply the change. This outcome is similar to how anti-dilution provisions are currently treated under IFRS 2.

The Group's Discussion

The Group generally agreed with the above analysis that there would be no modification to the plan if the share-based payment arrangement (sometimes referred to as the award documents) specified how to account for a change in non-performance market conditions. However, the Group emphasized that this conclusion depends on the level of specificity in the documents. For example, if an award document has an anti-dilution clause, the clause itself needs to be specific enough to apply to a particular scenario. The Group observed that in Canada, it is uncommon to see award documents with a level of specificity that contemplates how to factor in a change in the non-market performance condition due to a change in an accounting standard. Even if there is a modification to the plan, an entity still needs to assess whether the modification is beneficial to the employee for there to be an incremental accounting effect on the entity's financial performance.

Issue 2: Assuming that there is a modification to the plan, what should an entity consider when assessing whether the modification to a non-market performance condition that resulted from a change in accounting policy is beneficial or non-beneficial?

View 2A – Consider the absolute change to the non-market condition.

Proponents of this view consider looking simply at the face value of the change. Therefore, in this fact pattern, the modification would be non-beneficial because the EBITDA target increased.

View 2B – Consider all relevant facts and circumstances in making a determination of whether the modification is beneficial.

Proponents of this view note that although View 2A is simple to apply, it does not take into account the reason behind the change. For example, in the fact pattern if the accounting policy change decreased net income by CU300 and management decreased the target to CU700, the modification would be beneficial solely because of the direction of the change.

It is important to look at all relevant facts and circumstances when making the necessary judgment. Appropriate disclosure in the financial statements may be required under paragraph 122 of IAS 1 *Presentation of Financial Statements.*

View 2C – Consider a subset of relevant facts and circumstances in making a determination of whether the modification is beneficial.

This view is similar to View 2B, except that proponents of this view think that some relevant factors need to be applied but they may limit the factors to those that are considered relevant.

View 2D – Accounting Policy Choice.

Given IFRS Standards are silent on how an entity should make such determination, all three views are acceptable. An entity should choose an appropriate policy and apply it consistently.

The Group's Discussion

In discussing their views to Issue 2, several Group members considered the following scenarios.

	Original Scenario	Scenario 1	Scenario 2	Scenario 3
EBITDA Target	CU1,000	CU1,300	CU1,300	CU1,300
EBITDA Forecast*	CU1,000	CU1,300	CU1,100	CU1,500
Is the modification considered beneficial or non-beneficial to the employee?	Not applicable	Neutral (neither non-beneficial or beneficial)	Non-beneficial	Beneficial

*The EBITDA forecast is the original forecast adjusted solely for the change in accounting standards.

The Group's discussion focused on clarifying the difference between considering the absolute change to the non-market condition (View 2A) and considering all relevant facts and circumstances that are driving the change to the non-market condition (View 2B).

The Group discussed whether an entity looks at the modification using a two-step approach; that is, should the change from the original EBITDA target to the revised EBITDA target be split into two components. For example, the total change in the EBITDA target in Scenarios 2 and 3 is CU300 (i.e., from CU1,000 to CU1,300). Should the CU300 change be parsed out as follows to keep to the intent of what is described in View 2B?

- For Scenario 2, CU100 of the change relates to the effect from the change in accounting standards. Then CU200 of the change relates to the non-beneficial change because employees are asked to achieve a higher metric for their award to vest compared to the original EBITDA target.
- For Scenario 3, CU500 of the change relates to the effect from the change in accounting standards. Then, (CU200) of the change relates to a beneficial change because employees are asked to achieve a lower metric for their award to vest compared to the original EBITDA target.

If an entity were to apply View 2A (i.e., considering the absolute change to the non-market condition), then the entity would conclude that the modification is only made up of the CU300 increase in the EBITDA target. Some may hold the view that there is no need to compute an EBITDA forecast number to identify the effect of the change in accounting standard. This view is based on how some would read the words in IFRS 2 with respect to modifications to vesting conditions that are non-market performance related. Some Group members also noted the way that an entity views the modification could affect whether it needs to adjust the number of shares that would vest.

The Group's discussion indicated that there was support for both View 2A and View 2B. Group members noted that the adoption of IFRS 16 may be triggering entities to revisit non-market performance measures in their share-based payment arrangements because of the standard's effect on key metrics like EBITDA. However, some entities may build such changes into their next series of awards so that a modification to outstanding awards is not triggered. The Group noted that this issue has been discussed globally, with strong views held on both sides.

Overall, the Group's discussion raises awareness of the various views in practice on the issue of modification of non-market performance conditions. No further action was recommended to the AcSB.

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

Cryptocurrencies – Employee Benefits

The Group has discussed cryptocurrencies in various meetings:

- In January 2018, the Group discussed the accounting for investments in decentralized digital currencies (also referred to as cryptocurrencies). Various discussions have taken place since then (e.g., see the IFRS Interpretations Committee September 2018 meeting).
- In June 2018, the Group discussed various accounting issues related to the mining or validation of a cryptocurrency.

At this meeting, the Group discussed the accounting for transactions whereby an entity receives services from both non-employees and employees in exchange for a type of cryptocurrency that carries a right to transfer to another party (e.g., Bitcoin, Ethereum, and Litecoin).

Fact Pattern 1

- Entity X holds Bitcoins, which have been accounted for using the cost model under IAS 38 *Intangible Assets*.
- Entity X entered into an agreement to purchase services from a third party over a one-year period and has agreed to pay that party 12 Bitcoins (i.e., one Bitcoin per month) in exchange for the services.

Issue 1: How should Entity X account for its agreement to purchase services in exchange for Bitcoins?

View 1A – The services received should be measured at the fair value of the Bitcoins exchanged.

Proponents of this view analogize to the guidance in IAS 38 for exchanges of non-monetary assets. Paragraph 45 of IAS 38 states, in part, that "[t]he cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable."

Under this view, the transaction has commercial substance and should be recognized at the fair value of the Bitcoins given to exchange for the services. Entity X would recognize the difference

between the carrying value of the Bitcoins given up and the fair value of those Bitcoins in profit or loss.

View 1B – The services received should be measured at the carrying value of the Bitcoins exchanged.

Proponents of this view note that View 1A is for exchange of intangible assets and does not apply to exchanges of non-monetary assets for services. Therefore, the services should be recognized at the carrying amount of the Bitcoins exchanged.

View 1C – Entity X has an accounting policy choice.

Proponents of this view think that there is no guidance in IFRS Standards regarding exchanges of non-monetary assets for services; therefore, an accounting policy choice exists.

The Group's Discussion

Group members supported the view that Entity X should measure the services it received at the fair value of the Bitcoins exchanged (View 1A).

One Group member noted that in Fact Pattern 1, Bitcoins were accounted for as an intangible asset. Entity X disposed of the intangible asset and in accordance with paragraph 116 of IAS 38, the amount of consideration to be included in the gain or loss arising from the derecognition of the intangible asset is determined in accordance with IFRS 15 *Revenue from Contracts with Customers*. Paragraph 66 to 69 of IFRS 15 then provides guidance on measuring non-cash consideration at fair value, which provides support for View 1A.

A few Group members commented on the challenges with measuring the services received at the carrying value of the Bitcoins. Under View 1B, the measurement of the services can differ based on when the Bitcoins were acquired, which seems to produce an illogical outcome. It is more reasonable to associate the fair value of the services with the fair value of what is given up to attain the services. In this case, the fair value measure would be of the Bitcoins paid to the third party.

Some Group members also noted that the mode of payment should not change the cost of the service. This means that whether the services were paid with Bitcoins, U.S. Dollars or gold, the services should be at fair value. There was some discussion as to whether the fair value should be the Bitcoin itself, or the fair value of the services rendered. The Group noted that judgment would be applied to determine which fair value would provide the better measure. One Group member also thought that entities should consider whether there could be an embedded derivative in the arrangement.

Fact Pattern 2

- Entity Y entered into an agreement with one of its employees under which the employee will receive Bitcoins in exchange for providing services for three years.
- The number of Bitcoins that the employee will receive was determined up-front (i.e., nine Bitcoins) and the employee will receive the Bitcoins over the three-year term of the agreement (i.e., three Bitcoins per year). If the employee leaves Entity Y during the three-year term, he or

she will be entitled to a pro rata share of the Bitcoins earned to the date of termination or departure.

Issue 2: Are transactions in which an entity receives employee services in exchange for cryptocurrencies accounted for in accordance with IAS 19 Employee Benefits*?*

Analysis

The granting of Bitcoins to employees in exchange for services falls within the scope of IAS 19 based on guidance in paragraphs 2 and 8 of IAS 19.

Paragraph 2 of IAS 19 states that "[t]his Standard shall be applied by an employer in accounting for all employee benefits, except those to which IFRS 2 *Share-based Payment* applies." In addition, paragraph 8 of IAS 19 states that "[e]mployee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment."

An entity should consider the following when accounting for an arrangement in which an employee receives cryptocurrencies in exchange for providing services:

- Is the arrangement considered a short-term employee benefit or a long-term employee benefit?
- Does the arrangement meet the definition of a defined benefit plan or a defined contribution plan? If the arrangement is a defined benefit plan, the entity needs to consider the actuarial assumptions to be used in estimating the defined benefit obligation and the related expense.
- Are the Bitcoins that will be used to settle the obligation within an employee trust or have they have been set aside by the entity?

The Group's Discussion

The Group agreed with the above analysis, noting that the scoping paragraphs of IAS 19 would capture this type of transaction. The Group acknowledged the complexities involved in applying the IAS 19 measurement model, including the need to acquire actuarial assistance to determine the required assumptions related to the award.

The Group also discussed the following issue that was deferred from its June 2018 meeting.

Issue 3: Is there an active market as defined by IFRS 13 Fair Value Measurement *that allows measurement of cryptocurrencies at fair value?*

Analysis

IFRS 13 gives precedence to observable inputs over unobservable inputs, with Level 1 of the fair value hierarchy being quoted prices in active markets for identical assets or liabilities that an entity can access at the measurement date. IFRS 13 defines an active market as "[a] market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis."

An entity should consider the following factors when determining whether there is an active market for a particular cryptocurrency:

- IFRS 13 requires that the principal market for the cryptocurrency be determined as the market with the greatest volume and level of activity for that cryptocurrency. There may be several markets for a particular cryptocurrency.
- The entity must also have access to the market (e.g., some markets may be open only to constituents of a particular country).
- Some markets may trade in fractions of units of cryptocurrency, while others may trade in whole units. Therefore, the unit of account needs to be considered.
- The timing of measurement should also be considered as some exchanges may operate on a 24/7 basis. In such cases, the time at which the entity measures the cryptocurrency is important, given some cryptocurrencies experience significant pricing volatility.

It is possible that not all cryptocurrencies will meet the criteria for Level 1 in the fair value hierarchy, and that the hierarchy level for a particular cryptocurrency may change over time.

The Group's Discussion

Group members agreed with the analysis above, noting that whether there is an active market will depend on the type of cryptocurrency being held. It is important that entities include sufficient disclosures in their financial statements to help users understand the judgments made when determining whether there is an active market. One Group member noted that the judgments made would be similar to those made related to financial instruments that are traded in less established markets.

A Canadian member on the IFRS Interpretations Committee noted that the Committee discussed determining fair value for cryptocurrencies at its September 2018 meeting. A question was raised at the Committee as to the type of valuation model that would be applied to determine the fair value if an entity determined that there was no active market. In addition, there were some concerns expressed about the possibility of fraudulent transaction volumes in less transparent markets, a point that is not specifically contemplated in IFRS 13.

A representative of the Canadian Securities Administrators echoed the importance of providing sufficient disclosures to enable financial statement users to understand how the fair value of a particular cryptocurrency is determined. It is challenging to conclude that for some of the more mainstream cryptocurrencies, there is no active market. Judgment would be needed to determine which is the principal or most advantageous market given the different exchanges on which a particular cryptocurrency may be traded.

Overall, the Group discussed this topic of cryptocurrencies to raise awareness. 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 2 and IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation and Presentation

At its June 2018 meeting, the Group discussed several issues on cannabis accounting.[2] The Group had recommended discussing with the AcSB whether the issues of accounting for costs incurred related to biological transformation and presentation should be referred to the IASB or the IFRS Interpretations Committee.

In July 2018, the AcSB discussed the Group's recommendations and directed staff to conduct research on whether entities in other jurisdictions are encountering similar issues in applying guidance in IAS 41 Agriculture to account for biological assets. The AcSB decided it would continue its discussion of these issues at a future meeting. The next planned date of the AcSB discussion is in December 2018.

In October 2018, the staff of the Canadian Securities Administrators issued CSA Staff Notice 51-357 "Staff Review of Reporting Issuers in the Cannabis Industry." A representative of the Canadian Securities Administrators noted that the purpose of this notice is to highlight good disclosure practices for reporting issuers in the cannabis industry so that investors are provided with transparent information about financial performance, risks and uncertainties, to support informed decisions. Key points in the staff notice include making sure that fair value adjustments are disclosed separately from other profit or loss elements and that adequate disclosures are provided around fair value determination for cannabis. The staff notice also highlights that presenting a gross profit measure may be misleading if a reporting issuer applies an accounting policy of expensing costs of production as opposed to capitalizing direct and indirect costs. Reporting issuers are encouraged to provide supplemental information in the Management, Discussion and Analysis section about the cost to produce cannabis even if the policy is to expense costs of production.

Stakeholders are encouraged to read CSA Staff Notice 51-357 and stay abreast with developments in this area.

IFRS 16 and IAS 38: Cloud Computing Arrangements

At the June 2018 meeting, the AcSB staff reported to the Group that the AcSB sent a submission to the IFRS Interpretations Committee on the topic of cloud computing arrangements. The issue that the Group recommended is specific to an arrangement in which the customer pays fees to the supplier to access the supplier's hardware and application software.

The IFRS Interpretations Committee discussed the submission at its September 2018 meeting. Although the discussions indicate that there is likely no standard-setting action on this matter, there was debate on the drafting of the tentative agenda decision, particularly on the analysis around the right to access the software. The IFRS Interpretations Committee will continue its discussion at a future meeting and the AcSB staff will update the Group on any future developments.

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[2] At its June 2018 meeting, the Group discussed three cannabis topics:

- IFRS 13 and IAS 41: Cannabis Accounting – Recognition and Determining Fair Value
- IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation
- IAS 2 and IAS 41: Cannabis Accounting – Presentation

Cryptocurrencies

At the June 2018 meeting, the AcSB staff reported to the Group that the AcSB Chair shared the Group's discussion on this issue and other information gathered at the April 2018 meeting of the IASB's Accounting Standards Advisory Forum.

In September 2018, the IFRS Interpretations Committee discussed how an entity might apply existing IFRS Standards in accounting for holdings of cryptocurrencies and initial coin offerings. The IFRS Interpretations Committee provided advice to the IASB about: (i) the usefulness of information provided by existing IFRS Standards in relation to holdings of cryptocurrencies, and (ii) possible standard-setting activities the IASB could undertake. The AcSB staff is monitoring the international discussions in this area and will update the Group on any future developments.

OTHER MATTERS

IASB Discussion Paper: Financial Instruments with Characteristics of Equity

In June 2018, the IASB issued a Discussion Paper that explores improvements to IAS 32 *Financial Instruments: Presentation* for financial instruments that have characteristics of both a liability and equity. The IASB is seeking views on its proposed approach that would provide a clear rationale for why a financial instrument would be classified as either liability or equity, and enhance the information provided through presentation and disclosure. The AcSB hosted several IASB roundtables across Canada during the week of October 15, 2018 on this Discussion Paper. Canadian stakeholders are encouraged to submit their comments to the IASB by January 7, 2019.

Liabilities in Relation to a Joint Operator's Interest in a Joint Operation

In September 2018, the IFRS Interpretations Committee published a tentative agenda decision on the recognition of liabilities by a joint operator in relation to its interest in a joint operation. The IFRS Interpretations Committee observed that the liabilities a joint operator recognizes include those for which it has primary responsibility. The fact pattern submitted may be of interest to certain sectors in Canada (e.g., mining and oil and gas). Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period if they have any concerns with the tentative agenda decision.[3]

IBOR Reform

In June 2018, the IASB decided to add a research project on the financial reporting effect of the interbank offered rate (IBOR) reform given the urgency of this topic. The IBOR reform stemmed from recommendations from the Financial Stability Board in July 2014 that included measures for strengthening benchmarks and other potential reference rates based on interbank markets, and developing alternative nearly risk-free benchmark rates. Since then, significant progress has been made in identifying new or existing risk-free rates that could be used instead of IBORs. In July 2017, the UK's Financial Conduct Authority indicated that it would not use its influence or legal powers to

[3] The Group discussed the IFRS Interpretations Committee's tentative agenda decision at its October 2018 meeting (i.e., IFRS 11 and IFRS 16: Identifying the Customer in a Lease Contract for the use of Assets by a Joint Arrangement).

persuade or compel banks to submit data for the London inter-bank offered rate (LIBOR) after the end of 2021. As a result, there is a view that LIBOR will be discontinued after that point.

IBORs are used extensively in the global financial markets by a variety of market participants and in a number of different financial products. The transition away from IBORs to alternative risk-free rates could have a significant effect on financial reporting. For example, consider the impact this reform may have on derivative contracts with terms that extend beyond 2021 that refer to LIBOR as the reference rate. There could be accounting implications relating to modifications of contractual interest rates in outstanding financial instruments as well as to existing hedge accounting arrangements. Stakeholders are encouraged to stay abreast of developments on this topic.

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

PRIVATE SESSION

In November 2016, the AcSB expanded the Group's mandate to include assisting the Board in influencing the development of IFRS Standards (e.g., providing advice on potential changes to IFRS Standards). The Group's discussion of these matters supports the AcSB in undertaking various activities to ensure Canadian perspectives are considered internationally. Since these discussions do not relate to assisting stakeholders in applying issued IFRS Standards, this portion of the Group's meeting is generally conducted in private (consistent with the AcSB's other advisory committees).

IASB Document for Comments

At the October 2018 meeting, the Group provided input to the IASB member and staff on the IASB's Discussion Paper, "Financial Instruments with Characteristics of Equity."