IFRS Discussion Group

Report on the Public Meeting

June 13, 2013

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board (AcSB) regarding issues arising on the application of International Financial Reporting Standards (IFRSs) in Canada. The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the AcSB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of the AcSB and is based on discussions during the Group's meeting.

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

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

Items Presented and Discussed at the June Meeting

First Quarter 2013 Financial Statements

IFRS 3: Determining What Is Part of a Business Combination Transaction

IFRS 9: Early Adoption of IFRSs with Prospective Application

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IFRS 13: Fair Value Measurement Disclosure Challenges

IFRS 13 and IAS 36: Interplay between Fair Value Measurement and Impairment

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Update on Previous Items Discussed by the Group

New Searchable and Sortable Issues Database

ITEMS PRESENTED AND DISCUSSED AT THE JUNE MEETING

First Quarter 2013 Financial Statements

Group members discussed their experiences relating to first quarter financial statements following the initial application of new and amended IFRSs effective for annual periods beginning on or after January 1, 2013 including:

- IFRS 10 *Consolidated Financial Statements*;
- IFRS 11 *Joint Arrangements*;
- IFRS 12 *Disclosure of Interests in Other Entities*;
- IFRS 13 *Fair Value Measurement*; and
- IAS 19 *Employee Benefits* (Amended 2011).

The Group's Discussion

Group members offered a number of observations about the application of the new or amended IFRSs in the first quarter for entities with a calendar year end including:

- *IFRS 10* – More effort and time was required to apply this standard by entities with structured entities or many related parties compared to traditional operating companies. A more challenging aspect of the new standard is the requirements surrounding de facto control. Group members observed that it will be interesting to watch how the approach taken in Canada on using judgment in the application of this standard compares to those judgments made by entities in other jurisdictions that will adopt this standard at a later date.

- *IFRS 11* – An area of focus was assessing when "other facts and circumstances" were relevant in determining the classification of a joint arrangement (paragraph B13(b)(ii) of IFRS 11). Also, explaining the accounting consequences of a change in the basis of measurement on initial adoption was challenging. For example, moving from proportionate consolidation to the equity method was one of the most commonly noted effects of applying the new standard.

- *IFRS 12* – Although many of the disclosure requirements are not applicable for interim financial statements, a number of entities tried to get a head start on providing some of the disclosures that will be required in the annual financial statements under this standard.

- *IFRS 13* – The magnitude of fair value disclosures for financial instruments required for interim financial statements was surprising. Also, these new disclosure requirements were difficult to apply, particularly because IAS 34 *Interim Financial Reporting* does not specifically include the required interim disclosures. Instead, IAS 34 includes a cross reference to several specific paragraphs in IFRS 13 and limits the scope of those paragraphs to financial instruments only for the interim periods.

- *IAS 19 (Amended 2011)* – Applying the revised standard resulted in significant changes for entities with defined benefit plans. Also, explaining how and why these changes occurred was challenging due to the complexity involved and results that, at times, could be considered to be counter-intuitive.

IFRS 3: Determining What Is Part of a Business Combination Transaction

IFRS 3 *Business Combinations* requires an acquirer to determine whether a transaction is part of the exchange for an acquiree or is separate from the business combination. The acquirer and acquiree may have a pre-existing relationship before negotiations for the business combination begins, or they may enter into an arrangement during the negotiations that is separate from the business combination.

Paragraphs 51 and 52 of IFRS 3 provide guidance for the acquirer to determine what is part of the business combination transaction. Paragraphs B50 to B60 provide the related application guidance.

Fact Pattern

- On April 30, 2013, Buyer Co bought Seller Co's net assets that are linked with its activities of selling furniture (Buyer Co has not bought the shares of Seller Co). Parent Co owns 100 percent of Seller Co's shares. The acquisition is a business acquisition in accordance with IFRS 3. The purchase price is as follows based on the Purchase Agreement:
    - $17 million in cash, equal to the amortized cost and repayment amount of a loan from Bank A to Seller Co, which was paid directly by Buyer Co to Bank A;
    - $8 million in cash payable by Buyer Co to Seller Co; and
    - the issuance of 5 million fully paid preferred shares of Buyer Co to Seller Co having an issue price of $5 million.
- The preferred shares are redeemable at any time after April 30, 2018 upon request of the holder at their redemption price. The redemption price is based on a formula and can represent an amount between zero and $5 million depending on the volume of sales made by Buyer Co to Parent Co in the next five years (based on historic annual sales of $6 million made by Seller Co to Parent Co). If there are no sales, the redemption price will be zero. Parent Co can also buy products from suppliers other than Buyer Co and regularly does so. Sales between Parent Co and Buyer Co will be made at market price.
- The fair value of the preferred shares has been estimated at $1.9 million as at the acquisition date. Buyer Co and its valuators consider that there is no identifiable asset related with the fact that the redemption price of the shares is based on sales (for example, a sales/purchases agreement). Moreover, they consider that the transaction is not a bargain purchase and results in a small amount of goodwill, and that the estimated fair value of other assets and liabilities is adequately established.

- The Purchase Agreement includes a non-compete clause, requested by Buyer Co to protect its interests, which has a fair value of $1 million.

The Group considered the three transactions described in the fact pattern:

- repayment of a bank loan;
- issuance of preferred shares; and
- payment for a non-compete clause.

The Group considered whether each transaction is part of the business combination and recognized as part of applying the acquisition method (*View A*) or a separate transaction that is not part of the business combination (*View B*).

The Group's Discussion

Repayment of the bank loan

Group members asked a number of questions to obtain further details about the fact pattern:

- Is it clear from the purchase and sale agreement that the debt has actually been assumed by the acquirer legally?
- Why was the bank loan repaid?
- Is the repayment of the bank loan mandatory or discretionary?
- Does the bank loan agreement contain a change of control clause that triggered repayment?
- Is the repayment a feature of the purchase and sale agreement?

Group members noted that answers to these questions would be necessary to provide their view on this issue and a full understanding of the facts and circumstance surrounding a business combination is important. For example, the answers may have implications in determining the fair value of the bank loan and an assumption that the fair value of the bank loan is equal to the carrying amount may not be valid. Group members observed that the appropriate answer depends on a careful analysis of the legal terms of the arrangement (i.e., whether the debt legally assumed by the acquirer), noting that the method of payment in this fact pattern is less critical.

Group members also noted that a careful evaluation of all facts and circumstances is necessary and the facts around each transaction must be challenged when determining whether it is part of the combination itself or should be accounted for as a separate transaction.

Issuance of preferred shares

Group members asked questions to understand the reasons, intentions and motivations for issuing the preferred shares:

- Were the shares issued to resolve an uncertainty over the business value?
- Were the shares issued to give Parent Co an incentive to purchase from Buyer Co in the future?

- What are the facts and thought process that support a $1.9 million valuation of the preference shares?
- How did Buyer Co and its valuators arrive at a $1.9 million value but at the same time conclude that there is no customer relationship or other asset acquired?

Group members noted that it is difficult to determine the appropriate accounting treatment based on the facts presented and the questions that remain.

Group members observed that contingent consideration is usually not one sided. Instead, contingent consideration is usually negotiated by both parties to resolve a disagreement between the buyer and seller over how much the business is worth. The fact pattern being considered describes no such negotiation, which suggests the transaction may be something other than contingent consideration such as a volume rebate or customer acquisition cost.

Group members observed there is a risk that some may jump to a conclusion that the arrangement represents contingent consideration too hastily because of the attention given to this aspect of IFRS 3 during the initial transition to IFRSs. However, it is important to remember that everything that occurs in connection with a business combination that depends on future events is not necessarily contingent consideration.

Group members noted that although it may not be clear what the appropriate accounting is, it is quite clear what the wrong accounting is. If an accounting treatment produces an unusual result that doesn't appear to make sense, further thought is generally necessary and time should be taken to reassess whether all facts have been obtained and appropriately considered.

Group members noted that it is important to understand the motives, objectives, and economics behind the transaction prior to arriving at a conclusion regarding the appropriate accounting treatment under IFRSs.

Payment for a non-compete clause

Group members noted there was a potential for diversity based on whether paragraphs 51 and 52 of IFRS 3 are read literally or more broadly. Group members observed that regardless of how these paragraphs are read, if an entity captures the economics of the transaction properly, the resulting effect should be the same on a substantive level.

Several Group members noted that, in practice, a non-compete clause is often considered part of a business combination. Also, a non-compete clause is often requested by the buyer but not always. For example, the vendor could request a non-compete clause in certain circumstances that may result in a more favourable tax treatment.

Group members noted that whether or not the non-compete clause is considered part of the business combination is less important as long as the correct amount of consideration is allocated to the acquisition of the intangible asset. The Group did not recommend any further action be taken because eliminating the diversity in practice would not improve financial reporting, given that the two views do not ultimately produce significantly different financial reporting outcomes.

IFRS 9: Early Adoption of IFRSs with Prospective Application

Securities regulators have previously indicated that they would consider exemptive relief applications that pertain to an issuer wanting to adopt a standard early but unable to do so solely due to the timing difference between a standard becoming part of IFRSs and becoming part of Canadian GAAP. The AcSB Staff Financial Reporting Commentary, "Newly Issued IFRSs: Early Adoption and Advance Disclosure Issues," discusses this timing difference.

Questions have arisen on whether early adoption of an IFRS with prospective application may cause difficulties for entities that are required to prepare their financial statements in accordance with both Canadian GAAP applicable to publicly accountable enterprises and IFRSs issued by the IASB.

The IASB expects to issue IFRS 9 *Financial Instruments: Hedge Accounting* in the third quarter in 2013. Entities that wish to adopt these requirements before the AcSB incorporates the amendments into Part I of the Handbook will need to consider the effect of this timing difference.

Hypothetical Example

- Assume that the amendments to IFRS 9 for hedge accounting are:
    - issued by the IASB and become part of IFRSs on June 15, 2013; and
    - issued by the AcSB into Part I of the Handbook and become part of Canadian GAAP on August 30, 2013.
- Assume an entity with a calendar year end wants to adopt IFRS 9 and the new hedge accounting requirements for its interim financial statements for the three and six months ended June 30, 2013.
- Assume this entity can meet all the necessary requirements to adopt IFRS 9, including the hedge accounting requirements, for its second quarter filing.

In this hypothetical example, the earliest possible date that the entity could adopt the new hedging requirements is June 15, 2013. The interim report period (June 30, 2013) falls between the date the new hedge accounting requirements become part of IFRSs and the date those amendments become part of Canadian GAAP. Accordingly, the entity's second quarter interim financial statements would not be in compliance with Canadian GAAP if the entity decides to adopt the new hedge accounting requirements before those amendments are issued by the AcSB. The entity would need to apply for exemptive relief from securities regulators to adopt the new hedge accounting requirements for at least the second quarter filing and possibly longer.

The Group considered whether the effect of the difference between Canadian GAAP and IFRSs would be limited to the second quarter only (*View A*) or whether it would remain throughout the term of the hedging relationship (*View B*).

View A – The difference is temporary.

Proponents of this view argue that only the date that the new requirements become part of IFRSs is relevant in determining when hedges could be designated as such under the new requirements.

Therefore, once the new hedge accounting requirements are incorporated into Canadian GAAP, the entity would be able to file its third quarter interim financial statements and all future financial statements in accordance with both Canadian GAAP and IFRSs as issued by the IASB.

Under this view, the entity would need to request exemptive relief to comply only with IFRSs as issued by the IASB for its second quarter interim financial statements. The difference between IFRSs and Canadian GAAP would be temporary and limited to the second quarter financial statements.

View B – The difference remains throughout the term of the hedging relationship.

Proponents of this view argue that the earliest date that the entity could designate a hedge under Canadian GAAP using the new hedge accounting requirements is the date the new requirements become part of Canadian GAAP based on the hypothetical transition guidance presumed. The difference between IFRSs and Canadian GAAP would exist for the term of the hedging relationship because there would be two different designation dates for the use of the new hedge accounting requirements.

Under this view, the entity would need to request exemptive relief to comply only with IFRSs as issued by the IASB for all future financial statements affected. The difference between IFRSs and Canadian GAAP would remain throughout the term of the hedging relationship and could extend beyond the second quarter financial statements.

The Group's Discussion

Group members noted that it is somewhat premature to discuss the issue until the final transition provisions are known. Although Group members hope the difference will be temporary (View A), a conclusion is not possible until the IASB issues the final standard and a careful examination of the actual transition provisions is performed.

The AcSB's Chair, Gord Fowler, observed that the timing difference between when an IFRS is issued by the IASB and endorsed by the AcSB could be up to five months depending on the length of the IFRS and the translation resources available. This process is not unique to Canada and other jurisdictions face similar challenges with many experiencing a longer timing difference.

The Group observed that any problems that an entity may face only arise when an entity decides to adopt an IFRS before the AcSB incorporates the standard into the Handbook. Accordingly, an entity can avoid this issue by waiting until the required due process is completed and the new standard is incorporated into the Handbook.

The Group did not recommend action at this time but expects further discussion after the IASB issues the standard and the actual transition provisions are known.

IFRS 11: Presentation of Joint Venture Equity Income

IFRS 11 *Joint Arrangements* requires an entity to recognize an interest in a joint venture using the equity method and does not permit the use of proportionate consolidation.

An entity that used the proportionate consolidation method to account for its interest in a joint venture previously under IAS 31 *Interests in Joint Ventures* reported its proportionate share of revenues and operating expenses of the joint venture in its statements of comprehensive income. As a result, any operating income subtotal presented prior to applying IFRS 11 included the entity's proportionate share of operating income of the joint venture.

Some entities conduct elements of their core business activities using joint venture structures and have significant and profitable joint ventures. Upon adoption of IFRS 11, the question arises whether these entities can present the line "share of the profit or loss of joint ventures accounted for using the equity method" within the operating income subtotal and, if so, under which scenarios.

Fact Pattern 1:

- Entity A has significant joint ventures operations that are:
  - consistent with its core operating activities; and
  - significant in magnitude to those core operating activities.
- Before applying IFRS 11, Entity A:
  - accounted for its joint ventures operations using proportionate consolidation; and
  - presented a subtotal for operating income in its statement of comprehensive income.
- Entity A does not have any equity accounted for investments in associates.

For the first fact pattern, the Group considered whether it is appropriate for Entity A to present the equity accounted for share of profits of joint ventures within its operating income subtotal in its statement of comprehensive income.

View A: No. The share of joint venture income cannot be part of operating income.

Proponents of View A argue that including the share of profit or loss of joint ventures accounted for using the equity method in operating income is not appropriate because this figure would likely include significant amounts of financing, income tax amounts and other items pertaining to the joint venture's operations that are not operating in nature.

View B: Yes. The share of joint venture income can be part of operating income.

Proponents of View B argue that Entity A can present an operating income figure, which includes the results of material joint ventures used to conduct operations that are consistent with the core business operations of the entity because these activities are operating in nature.

The Group's Discussion – Fact Pattern 1

Group members supported View B noting that it is difficult to preclude either approach because IAS 1 *Presentation of Financial Statements* prescribes minimum requirements and does not

define, require or prohibit an operating income subtotal. Group members observed that from a user perspective, it does not matter where the information is presented as long as it is disclosed separately. Group members noted that View A is not particularly convincing because it is equally problematic to argue the amount should be excluded from operating income given that it includes items that are operating in nature.

Group members observed that some hold the view that almost every activity is operating in nature if it is part of the business. A conclusion that an activity is not part of a business and not operating in nature gives rise to questions about why the activity occurs.

Fact Pattern 2:

- Entity B has the same fact pattern as Entity A, except that Entity B also has an investment in an associate that represents a passive investment, unrelated to its core business operations, that is accounted for using the equity method.
- Before applying IFRS 11, Entity B's share of profit and loss of associates was presented after the subtotal for operating income and below financing costs.

For the second fact pattern, the Group considered whether paragraph 82(c) of IAS 1 requires Entity B to present an aggregate amount for "share of the profit or loss of associates and joint ventures accounted for using the equity method" in its statement of comprehensive income.

View C: Yes. An aggregate amount is required.

Proponents of View C argue that Entity B could no longer present a subtotal for operating income on the face of the statement of comprehensive income because doing so would prevent Entity B from complying with paragraph 82(c) of IAS 1.

View D: No. Multiple amounts are permitted and a subtotal for these amounts is not required.

Proponents of View D argue that paragraph 82 of IAS 1 does not explicitly require a subtotal that aggregates the investor's share of profit and losses of associates and joint ventures. Entity B should separately present its share of profit and losses of associates (which do not form part of operations) and joint ventures (which do form part of its operations) because this presentation is considered necessary to the user's understanding of the financial statements. To the extent that an entity has multiple joint ventures, IFRSs do not prohibit presenting the results of those joint ventures that do not form part of operations in a separate line item from those that do.

The Group's Discussion – Fact Pattern 2

Group members supported View D noting that IAS 1 does not prevent additional line items and does not require a subtotal for all such items. Group members observed that paragraph 82(ea) of IAS 1 specifies "a single amount …", which implies that paragraph 82(c) permits multiple amounts.

Group members observed that subtotals and captions for describing those subtotals have been an area of focus for regulators. Cameron McInnis, Chief Accountant of the Ontario Securities

Commission, noted that they hear from investors that operating income is an important measure and that discussions on this topic are also occurring at an international level.

Although there have been requests made to the IASB by other jurisdictions for more guidance on operating income, a common definition that can be applied across all industries, sizes of companies and jurisdictions will likely not be achievable.

The Group did not recommend any further action be taken.

IFRS 13: Fair Value Measurement Disclosure Challenges

IFRS 13 *Fair Value Measurement* requires disclosure of information that helps users of financial statements assess the following:

- For assets and liabilities measured at fair value on a recurring and non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.
- For fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

The illustrative examples that accompany IFRS 13 include five examples to illustrate these disclosures (Examples 15-19 in paragraphs IE 60-IE66).

IAS 34 *Interim Financial Reporting* was amended as a consequence of issuing IFRS 13 to require additional disclosures about fair value of financial instruments in interim financial statements. Paragraph 16A(j) of IAS 34 requires entities to make in the interim financial statements the majority of the disclosure requirements about the fair value of financial instruments that will be required in their 2013 annual financial statements.

Paragraph 16A in IAS 34 states, in part:

> "In addition to disclosing significant events and transactions in accordance with paragraphs 15–15C, an entity shall include the following information in the notes to its interim financial statements, if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis.
>
> (a) …
>
> (j) for financial instruments, the disclosures about fair value required by paragraphs 91–93(h), 94–96, 98 and 99 of IFRS 13 *Fair Value Measurement* and paragraphs 25, 26 and 28–30 of IFRS 7 *Financial Instruments: Disclosures*."

Although these disclosure requirements for interim financial statements relate only to financial instruments, fair value disclosures related to non-financial assets and liabilities may be necessary in interim financial statements in some limited circumstances when required under paragraph 15 of IAS 34.

The Group considered the major changes to fair value financial instruments disclosures for interim periods beginning on or after January 1, 2013.

The Group's Discussion

Group members noted that the new requirements are a relatively long list of disclosures. Most of these disclosures fit into four categories:

- overarching disclosure objectives (paragraphs 91, 92 and 94 of IFRS 13);
- financial assets and financial liabilities measured at fair value (paragraphs 93 and 98 of IFRS 13);
- fair value measurements categorized within Level 3 of the fair value hierarchy for financial assets and financial liabilities (paragraph 93 of IFRS 13);
- financial instruments not measured at fair value but for which fair value is disclosed (paragraphs 25, 26 and 28-30 of IFRS 7).

Group members observed that one of the most challenging aspects of the new disclosures required for Level 3 fair value measurements relate to the quantitative information about significant unobservable inputs.

Although IFRS 13 does not provide specific guidance on what information is required, example 17 in paragraph IE63 of the illustrative examples for IFRS 13 may be helpful. The additional disclosure requirements for Level 3 measurements include:

(a) For recurring fair value measurements (paragraph 93(h)(i) of IFRS 13):
  - a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in the inputs would result in significantly higher or lower fair value measurements; and
  - a description of the interrelationships between unobservable inputs and how the interrelationship affects the sensitivity analysis.

(b) Quantitative information about the significant unobservable inputs used in the fair value measurement, unless the inputs were not developed by the entity. However, an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity (paragraph 93(d) of IFRS 13).

(c) A reconciliation of movements in fair value of opening to closing balances for recurring fair value measurements (paragraph 93(e) of IFRS 13). Reconciling items are required for:
  - amounts in profit or loss (and the line item in which they are recognized);
  - amounts in other comprehensive income;
  - amounts of purchases, sales, issues and settlements (separately by type); and
  - amounts of transfers in or out of Level 3, including the reasons for the transfers and the entity's policy for determining when the transfers are deemed to have occurred).

(d) For fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity for both recurring and non-recurring fair value measurements (Paragraph 93(g) of IFRS 13). Paragraph IE65 of the illustrative

examples for IFRS 13 indicates an entity might disclose the following to comply with paragraph 93(g):

- for the group within the entity that decides the entity's valuation policies and procedures:
  - its description;
  - to whom the group reports; and
  - the internal reporting procedures in place;
- the frequency and methods used for calibration, back testing and other testing procedures of pricing models;
- the process for analyzing changes in fair value measurements from period to period;
- how the entity-determined third party information used in the fair value measurement was developed in accordance with IFRSs; and
- the methods used to develop and substantiate the unobservable inputs used in a fair value measurement.

(e) A description of the valuation processes used and whether there has been any change to the process for fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy (paragraph 93(d) of IFRS 13).

Group members observed that this relatively long list represents only one of the four categories of new disclosures noted above. The above list of disclosures would be longer if it included all of the new interim financial statement disclosures that paragraph 16A(j) in IAS 34 requires.

Cameron McInnis, Chief Accountant of the Ontario Securities Commission, noted that entities should remember when looking at a long list of disclosure requirements to avoid a checklist mentality. Entities should consider materiality and provide thoughtful, informative disclosures that are useful to investors.

The Group did not recommend any further action be taken.

IFRS 13 and IAS 36: Interplay between Fair Value Measurement and Impairment

IFRS 13 *Fair Value Measurement* provides a definition of fair value and sets out a framework for measuring fair value that is to be applied when another IFRS permits or requires fair value measurements or disclosures.

IAS 36 *Impairment of Assets* requires that an asset is evaluated for impairment based on a comparison of recoverable amount and carrying amount. Recoverable amount is the higher of:

- value in use; and
- fair value less costs of disposal.

IFRS 13 provides specific guidance on the application of IFRS 13 to non-financial assets that encompasses those within the scope of IAS 36. Paragraphs 27 and 28 of IFRS 13 require that the measurement of fair value be based on the "highest and best use" of a non-financial asset taking

into account the use of the asset that is physically possible, legally permissible and financially feasible.

The concept of the highest and best use requires the establishment of the appropriate unit of account for measurement of the asset in question. The unit of account in IAS 36 is the cash-generating unit, which is defined as the "smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets."

Questions have arisen about the effect of IFRS 13 on the determination of recoverable amount under IAS 36 including how the highest and best use concept interacts with the notion of a cash-generating unit.

Fact Pattern

- Entity A has retail outlets around the country and under the requirements of IAS 36, each retail store represents a cash-generating unit (referred to as a "CGU").
- Entity A determines that the value in use for one CGU is less than the carrying amount. The retail store in this CGU is located in a booming condominium real estate market. Entity A also has:
  - a brand that was acquired and is not actively used but rather is held defensively to prevent others from using it; and
  - corporate assets that include an office building in downtown Toronto, which is fully occupied by Entity A.

The Group considered the following questions:

- What are the implications of adopting IFRS 13 on the determination of the recoverable amount by Entity A?
- How does the application of the highest and best use concept affect this measurement?

The Group's Discussion

Group members observed that fair value less costs of disposal needs to be considered for the one CGU in this fact pattern because the value in use is less than the carrying amount. As described in paragraph 19 of IAS 36, if either fair value less costs of disposal or value in use exceeds the carrying amount, the asset is not impaired and it is not necessary to estimate the other amount. Group members noted that for many companies, value in use of the assets or group of assets will exceed carrying values and no further consideration of how IFRS 13 interacts with IAS 36 will be required.

However, in this fact pattern, value in use is less than the carrying amount. Accordingly, a fair value calculation in accordance with IFRS 13 is necessary and the fact that the retail store is located in a booming condominium real estate market becomes relevant because the fair value less cost to dispose must be determined in accordance with IFRS 13, which requires the highest and best use assumption for non-financial assets. If the fair value of the land, less costs to rezone the land, demolish the store and dispose of any machinery and equipment, was greater than the

value in use, the highest and best use would be to presume that the land will be rezoned for condominium development, provided it is legally feasible.

Group members observed that the unit of account is set out in IAS 36 and does not change with the application of IFRS 13. Paragraph 32 of IFRS 13 states, in part, that "the fair value measurement of a non-financial asset assumes that the asset is sold consistently with the unit of account specified in other IFRSs (which may be an individual asset)."

Group members noted that usually management will be deploying an asset at its optimal use. As a result, paragraph 29 of IFRS 13 provides a rebuttable presumption that an entity's current use of a non-financial asset is its highest and best use unless market or other factors indicate otherwise. Preparers need to use available information but do not need to perform an exhaustive search for alternative uses. Generally, management should be able to readily identify any asset that is being used by the entity suboptimally for reasons specific to the entity.

Some Group members asked what changes arise in how IAS 36 should be applied following the adoption of IFRS 13. Other Group members explained that IFRS 13 puts more structure around determining fair value less costs of disposal and provides more explicit guidance. (Paragraph 140I of IAS 36 provides the paragraph references for the consequential amendments made to IAS 36 for IFRS 13.) IFRS 13 forces the preparer to consider the external hypothetical market participant.

In addition, if one asset in a group of assets is considered to have a highest and best use to external market participants, which is a different use than the current use, there may be potential consequential implications to the determination of fair value of the other non-financial assets in the CGU because of the requirement in paragraph 31(a)(iii) of IFRS 13 to use consistent assumptions for all the assets in the group.

Group members observed that the interplay between IAS 36 and IFRS 13 can give rise to some tension and a need to reconcile the required level of testing. This tension may often be resolved with a more realistic view of the interdependencies of the assets and cash flows and may focus attention on whether an entity's CGUs are appropriate.

Group members observed that this topic was added to the Group's agenda to raise awareness of the considerations that arise when determining fair value less costs of disposal.

The Group did not recommend any further action on this topic.

IAS 1 and IAS 7: Classification of Restricted Cash

The Group is asked to consider whether cash or a cash equivalent that has an external restriction placed upon it should be:

- presented as current or non-current on the statement of financial position; and
- considered a cash equivalent for statement of cash flow purposes.

Paragraph 66 of IAS 1 *Presentation of Financial Statements* states:

> "An entity shall classify an asset as current when:
>
> (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
>
> (b) it holds the asset primarily for the purpose of trading;
>
> (c) it expects to realise the asset within twelve months after the reporting period; or
>
> (d) the asset is cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.
>
> An entity shall classify all other assets as non-current."

Paragraph 6 of IAS 7 *Statement of Cash Flows* defines cash and cash equivalents as follows:

> *"Cash* comprises cash on hand and demand deposits.
>
> *Cash equivalents* are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value."

Fact Pattern

- A company operates a mine in a jurisdiction that requires a set amount of cash or cash equivalents to be held in a special account to be used only for the remediation of the mine site at the end of the life of the mine.
- The cash equivalents are demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.
- The company's mine has an estimated remaining life of 10 years.

The Group considered whether the restricted amounts should be presented as current or non-current on the statement of financial position and whether these restricted amounts should be considered cash equivalents for statement of cash flow purposes.

The Group's Discussion

Group members observed that in this fact pattern, the criterion in paragraph 66(d) of IAS 1 is not met because the amounts are restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period. The amounts held in the special account should be presented as a non-current asset in the statement of financial position.

To clarify the fact pattern, Group members assumed the statement of financial position presents as a current asset, cash and cash equivalents of $10 million, and as a non-current asset, restricted amounts held in the special account of $3 million. Group members considered whether the statement of cash flows should reconcile to $10 million (*View A*) or $13 million (*View B*)?

Many Group members supported the view that the restricted amounts should not be presented in the statement of cash flows as part of cash equivalents (*View A*) because these funds are not available to meet short-term cash commitments. Group members observed that paragraph 7 of IAS 7 states, in part, that "cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes."

However, Group members questioned whether the critical fact providing clarity in this fact pattern is the length of the restriction rather than the nature of the restriction. Group members observed that determining the appropriate presentation in the statement of cash flows becomes more difficult for other scenarios (for example, a restriction that a special account must be used for a specific purpose, such as building a mine, but the expenditures will be made three to six months after the reporting period). In this scenario, the amounts in the special account are not freely available for use but are expected to be used within the next year. Group members noted that it is less clear whether the statement of cash flows should be reconciled to cash and cash equivalents that include these restricted amounts.

Some Group members held the view that the restricted amounts should not be presented in the statement of cash flows as part of cash equivalents. Other Group members observed that both approaches can be seen in practice and it may be difficult to preclude the alternative view in certain scenarios.

Group members observed that the facts and circumstances, including the nature of the restriction, must be considered when determining the appropriate presentation in the statement of cash flows.

The Group decided not to recommend further action to the AcSB regarding this issue.

IAS 10: Subsequent Events Relating to Uncertain Tax Positions

Decisions taken by an entity in measuring its income tax assets and liabilities for financial statement purposes when the tax law is unclear are generally referred to as uncertain tax positions.

IAS 12 *Income Taxes* does not provide any detailed guidance regarding the recognition and measurement of uncertain tax positions. Additionally, income tax is excluded from the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. With the lack of guidance in IFRSs, a number of methodologies for accounting for uncertain tax positions exist in practice. Regardless of the approach taken, an entity needs to consider how information obtained after the balance sheet date should be reflected in the recognition and measurement of an uncertain tax position at the balance sheet date in accordance with IAS 10 *Events after the Reporting Period*.

The issue for consideration is to what extent events after the reporting period (i.e., subsequent events) should be considered in the recognition and measurement of uncertain tax positions.

Fact Pattern:

- An entity filed its tax return in 20X1 based on a tax filing position and determined that an aspect of the filing position (such as the deductibility of a particular expense) is uncertain under the relevant tax law.
- The entity determined that there was a risk that the taxing authorities will not allow the deduction and a liability should be recorded in relation to the potential need to remit additional taxes to the relevant taxing authority.
- The entity recorded a liability of $100, in relation to 50 percent of a deduction of $800, which the entity thinks would not be sustained, at the substantively enacted tax rate of 25 percent.
- The entity is now preparing its December 31, 20X7 annual financial statements with a date of authorization of March 15, 20X8:
    - *Case 1:* In June of 20X7, the taxing authorities commence their examination of the position in question. The entity has not changed its previous assessment of the probability of sustaining the deduction and continues to think that 50 percent of the deduction will be denied. However, in January of 20X8, the entity receives a Notice of Reassessment denying the entire deduction of $800. The entity determines in January of 20X8 that it will pay the reassessed taxes of $200.[1]
    - *Case 2:* In June of 20X7, the taxing authorities commence their examination of the tax return. The entity thinks that the position in question is specifically considered as part of the examination. The entity has not changed its previous assessment of the probability of sustaining the deduction and continues to think that 50 percent of the deduction will be denied. However, in January of 20X8, the taxing authorities complete their examination and verify that there will not be a reassessment of the 20X1 taxation year.
    - *Case 3:* In February of 20X8, the tax position becomes statute-barred.

The Group considered the extent that the events after the reporting period (i.e., subsequent events) in each of the three cases should be reflected in the recognition and measurement of the uncertain tax position at the balance sheet date.

View A – No subsequent events should be reflected.

View B – All subsequent events should be reflected.

View C – All subsequent events should be reflected, with the exception of an uncertain tax position being resolved solely as a result of the passage of time.

The Group's Discussion

Most Group members who expressed a view supported View C, with some caveats. Several Group members observed that View A is unacceptable under IFRSs while others noted that some apply U.S. GAAP by analogy to support View A in practice. Group members observed that this

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[1] Interest is ignored for simplicity.

argument is not valid because the U.S. GAAP accounting treatment is an exception that does not exist in IFRSs and conflicts with IFRSs. Other Group members observed that View B may be difficult to preclude and all three views are present to some extent in practice.

Although some diversity appears to exist in practice, the Group decided not to recommend that the issue be brought forward noting that the issue is intertwined with the broader issue regarding whether uncertain tax positions are within the scope of IAS 12 or IAS 37, for which the IASB is aware of the need for guidance.

IAS 10: Reissuing Financial Statements in Connection with an Offering Document

At the January 2012 meeting, the Group recommended that the AcSB request clarification from the IFRS Interpretations Committee regarding the accounting implications of applying IAS 10 *Events after the Reporting Period* when reissuing financial statements in connection with an offering document as described above.

The IFRS Interpretations Committee discussed the AcSB's submission at its November 2012, January 2013 and May 2013 meetings. The Committee decided not to add this issue to its agenda, providing the following comments in its agenda decision published in the May 2013 IFRIC Update:

> "The Interpretations Committee noted that IAS 10 does not address the presentation of re-issued financial statements in an offering document when the originally issued financial statements have not been withdrawn, but the re-issued financial statements are provided either as supplementary information or a re-presentation of the original financial statements in an offering document in accordance with regulatory requirements.
>
> On the basis of the above and because the issue arises in multiple jurisdictions, each with particular securities laws and regulations which may dictate the form for re-presentations of financial statements, the Interpretations Committee decided not to add this issue to its agenda."

The Group discussed the implications of the IFRS Interpretations Committee's agenda decision for Canadian companies.

The Group's Discussion

Group members noted that the IFRS Interpretations Committee's agenda decision is helpful because it provides the needed clarity that IAS 10 does not address the presentation of reissued financial statements in an offering document when the originally issued financial statements have not been withdrawn.

Group members observed that the agenda decision provides a relatively clear signal that IFRSs do not preclude an approach that is consistent with dual dating in these circumstances. Further,

entities may be able to re-present previously issued financial statements in connection with an offering document and report that those financial statements comply with IFRSs.

Group members observed that the final agenda decision represented a change in direction from the previously held global view that dual dating was not permitted under IFRSs. This view was a consequence of the presumption that the general principles of IAS 10 should be applied in the context of reissuing previously issued financial statements in connection with an offering document. Under this view, it was difficult to reach a conclusion that dual dating was acceptable under IFRSs.

Group members explained that the IFRS Interpretations Committee's agenda decision allows individuals to look at this issue much differently because it clarifies that the circumstances being discussed are not addressed by IAS 10. As a result, views have evolved sufficiently to allow some flexibility in how an issuer accommodates regulatory requirements in these specific circumstances.

Further discussions continue regarding some details such as the auditors' report and presentation of discontinued operations. The final approach to reissuing financial statements in connection with an offering document will likely be established by the first few filings that trigger the related regulatory requirements.

The Group recommended that the Securities Regulation Advisory Group (referred to as "SRAG") may be an appropriate forum to explore some of the detailed issues and reporting implications of the IFRS Interpretations Committee's agenda decision. This Advisory Group is a standing committee of the Auditing and Assurance Standards Board (AASB) with the objective of assisting the AASB in all matters relating to securities regulation.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 8: IFRSs Issued but Not Yet Effective

At the July 2012 meeting, the Group recommended that the AcSB consider including guidance in the Handbook to clarify this issue.

The AcSB staff has posted a "featured item" article on the website, "Staff Commentary – Newly Issued IFRSs: Early Adoption and Advance Disclosure Issues," to help stakeholders understand the issues and the considerations affecting what they may be permitted or required to do in satisfying their financial reporting obligations.

The AcSB had issued an Exposure Draft prosing amendments to clarify the Preface to the CICA Handbook – Accounting and Introduction to Part 1 regarding new, revised or amended IFRSs.

These amendments were issued in the July 2013 Handbook update.

IAS 39: Implications for Hedging Relationships of Novation of Derivatives

At the July 2012 meeting, the Group considered the potential implications for certain financial institutions when a derivative contract in an existing, valid hedging relationship is required by regulation to be novated and transferred to a central clearing house for settlement. The Group observed that Canada was not the only country facing this issue and it was being discussed in other jurisdictions including Europe. Group members observed that any action the AcSB may take should not conflict with or slow down the evolution of the international discussions and agreed that there was no immediate action to recommend to the AcSB.

Since the Group's discussion in 2012, the IFRS Interpretations Committee had received a submission on this issue that lead to the IASB's February 2013 Exposure Draft, "Novation of Derivatives and Continuation of Hedge Accounting (Proposed amendments to IAS 39 and IFRS 9)."

The IASB's Exposure Draft proposed a narrow-scope amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* that would permit a continuation of the existing hedging relationship when the hedging instrument is novated from one counterparty to a central counterparty as a consequence of laws or regulations, if specific conditions are met.

At its May 2013 meeting, the IASB discussed an analysis of comment letters received, including the one from the AcSB. It tentatively decided to expand the scope of the amendments to permit continued hedge accounting for voluntary novation to a central counterparty associated with legislative and regulatory change, including when that novation provides the entity with indirect access to a central counterparty.

The IASB issued these amendments to IAS 39 and IFRS 9 at the end of June 2013.

IAS 1: Going Concern

At the March 2010 meeting, the Group discussed the requirements in paragraph 25 of IAS 1 *Presentation of Financial Statements* for management to disclose material uncertainties related to events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern. The Group recommended that the AcSB request that the IASB consider clarifying and expanding the going concern disclosure requirements in IAS 1 and a communication to that effect was subsequently sent to the IASB staff. In July 2010, the IFRS Interpretations Committee decided not to add the item to its agenda, noting in the agenda decision "that for this disclosure to be useful it must identify that the disclosed uncertainties may cast significant doubt upon the entity's ability to continue as a going concern."

In November 2012, the IFRS Interpretations Committee received a request from the International Auditing and Assurance Standards Board (IAASB) for clarification of paragraphs 25 and 26 of IAS 1. The IFRS Interpretations Committee decided to propose a narrow-scope amendment to IAS 1.

In March 2013, the IASB considered the IFRS Interpretations Committee's proposed amendment that:

- retains the guidance relating to going concern as a basis for the preparation of the financial statements substantially unchanged;
- provides guidance on how to identify material uncertainties; and
- contains requirements about what to disclose about material uncertainties.

The IASB discussed whether this issue should be addressed primarily by IFRSs, auditors or regulators. It also considered whether the volume of disclosures proposed was appropriate and whether it was clear when an entity would be required to make those disclosures. The IASB tentatively decided to develop the proposals recommended to them by the IFRS Interpretations Committee further. The IASB is expected to discuss these proposals again in September 2013. The IASB's work plan indicates a target date for an exposure draft for this narrow-scope amendment in the fourth quarter of 2013.

NEW SEARCHABLE AND SORTABLE ISSUES DATABASE

In April 2013, the AcSB staff launched a new searchable and sortable issues database containing the 126 issues discussed at the 13 meetings since the Group's inception. For each issue, the database includes a brief description as well as links to the meeting report extract and audio webcast. Stakeholders that face an issue in applying IFRSs can now quickly and easily find out if the Group has discussed that issue or a similar one.