IFRS® Discussion Group

Report on the Public Meeting

September 23, 2020

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

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

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

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

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ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

Income Statement Presentation of COVID-19 Impacts

The COVID-19 pandemic is having a significant economic effect on companies, many of which have experienced a significant reduction in revenue and incurred various expenses or loss as a result. In addition, some companies may have obtained government grants under various COVID-19 relief programs. When preparing interim and annual financial statements in accordance with IFRS® standards, management will need to consider how to present these COVID-19 related expenses and income in the income statement.

IAS 1 *Presentation of Financial Statements* contains guidance for the presentation of items in the income statement:

- Paragraphs 99- 105 of IAS 1 require an entity to present an analysis of its expenses classified based on their function (e.g., cost of sales, distribution and administration) or their nature (e.g., depreciation, purchase of materials and employee benefits), whichever provides reliable and more relevant information. This classification of expenses may be presented on the face of the income statement or in the notes and should be applied consistently from period to period.
- Paragraph 85 of IAS 1 requires that an entity present additional line items, headings and sub-totals in the income statement when such presentation is relevant to understanding the entity's financial performance. When an entity elects to present a separate subtotal for "income from operations", paragraph BC56 in the Basis for Conclusions to IAS 1 provides guidance on items that should be included in that subtotal.
- Paragraph 97 of IAS 1 also requires that when items of income or expense are material, an entity shall disclose their nature and amount separately, either in the income statement or in the notes to the financial statements.

The Group discussed four issues related to classifying and presenting various income and expense items related to COVID-19 in the income statement.

Issue 1: Consider the following examples. How should an entity classify the income and expenses related to COVID-19 in its income statement?

(a) **Expenses that continue to be incurred during COVID-19**: the entity may continue to incur certain expenses, such as wage and salaries for idled employees, during COVID-19 that are the same or similar to those incurred prior to COVID-19.

(b) **Expenses that are similar to those incurred before COVID-19 but are higher in amount**: for example, an entity may decide to pay its employees additional wages, such as temporary hazard pay, during the pandemic.

(c) **New items of income or expense that were earned or incurred because of COVID-19** (i.e. they would not have been earned or incurred if COVID-19 had not occurred). Examples of these items include:

- Additional costs incurred to clean and disinfect facilities
- Penalties for delayed or non-performance under contracts invoked directly as a result of the pandemic
- Rent concessions from lessors that occur as a result of COVID-19
- Recoveries from business interruption insurance where the policy covers claims arising from the pandemic

- Impairment loss arising directly from the impact of COVID-19

Analysis

Paragraph 45 of IAS 1 underscores the principle that financial statement presentation should be consistent from period to period. Therefore, when assessing the classification of these income or expenses items described above, management should consider the existing structure of the entity's income statement.

Expenses that continue to be incurred during COVID-19

Given these expenses were incurred before COVID-19, they should be classified based on their existing classifications in the entity's income statement. For example, if the entity classified the expenses by function, it would allocate the salary and wages for idle employees to the related functions. If the expenses are classified by nature, they are allocated to the existing line items in the income statement (e.g. employee benefit expense).

In addition, these expenses should be presented consistently period over period. They should not be "carved out" of existing line items in the income statement and presented separately.

Expenses that are similar to those incurred before COVID-19 but are higher in amount

Similar to the analysis above, given these expenses are similar to those incurred before COVID-19, the entity should classify them based on its existing classification of expenses (i.e. by function or by nature).

New income or expenses that were incurred because of COVID-19

In addition to considering the existing structure of its income statement, the entity should assess whether any of these incremental income or expense items should be presented as separate line items on the income statement. Doing so would be appropriate when such presentation is relevant to a user's understanding of the entity's financial performance. In making this determination, the entity needs to apply judgment and consider factors such as materiality and the nature and function of the items of income and expense. The entity should not describe any items of income or expense as "extraordinary items."

Where a new income or expense item arising from COVID-19 is material and is not presented separately on the income statement, its nature and amount should be disclosed. Such disclosure should be clear and transparent, describe how the item was earned or incurred in the context of COVID-19, and indicate where the amount is presented in the income statement.

The Group's Discussion

Group members agreed with the analysis, highlighting the principles in paragraph 45 of IAS 1 requiring an entity to have a consistent financial statement presentation from period to period.

Some Group members observed that in practice, many entities have chosen to detail how COVID-19 has impacted their financial performance through note disclosures and discussion in their Management Discussion and Analysis (MD&A) instead of changing their income statement presentation. These Group members supported this practice as it retains consistent income statement presentation while highlighting material, relevant information to financial statement users. One Group member observed that in practice, the indirect impacts of COVID-19, such as increased sales for certain products or higher prices for certain commodities, are often included in the MD&A instead of the financial statements. Therefore, this Group member thought that financial statement users should consider the information included in both the financial statements and the MD&A to have a complete understanding of COVID-19's impacts on an entity's performance.

Issue 2: If the entity presents a sub-total in its income statement for "income from operations", should it present COVID-19 related items within this sub-total?

Analysis

While IAS 1 does not define "income from operations," paragraph BC56 of the Basis for Conclusions on IAS 1 notes that "it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amount."

Therefore, it would not be appropriate for the entity to exclude COVID-19-related income or expenses from "income from operations" solely because they may be non-recurring or unusual. For example, in addition to restructuring expenses and inventory write-downs, cleaning expenses are typically part of operating expenses and presented as part of "income from operations". As such, incremental cleaning and sanitization expenses incurred to prevent the spread of COVID-19 may be unusual, but they are clearly related to operations and should be presented in "income from operations".

The Group's Discussion

Group members agreed with the analysis. They thought that income or expenses incurred to operate the business during the pandemic should be presented in "Income from operations". One Group member commented that an entity can provide additional information on its COVID-19 related expenses in the notes to the financial statements to help users better understand the cash flow impacts from the pandemic.

Fact Pattern for Issue 3

- Entity A has a factory that was closed or operated significantly below normal capacity from March to July 2020 due to the government imposed COVID-19 restrictions. During this period, Entity A continued to pay normal salary to its manufacturing employees while they were unable to work. Entity A also continued to depreciate its factory on a straight-line basis.
- Entity A capitalizes to inventory an allocation of fixed production overheads (such as factory depreciation) based on the factory's normal production capacity. The amount of fixed overhead allocated to each unit of production is not increased because the factory is idle or operating below normal capacity. Instead, unallocated fixed overheads are expensed in the period incurred in accordance with paragraph 13 of IAS 2 *Inventories*.

- Salary and wage continuance costs incurred while the factory is idle or operating below normal capacity are treated as "abnormal amounts" of labour and are expensed in the period incurred in accordance with paragraph 16(a) of IAS 2.

Issue 3: If Entity A classifies expenses by function and presents a separate line item for cost of goods sold (COGS), should it classify the unallocated fixed overheads and direct labour costs as part of COGS?

Analysis

Paragraph 38 of IAS 2 states that "the amount of inventories recognised as an expense during the period, which is often referred to as **cost of sales**, consists of those costs previously included in the measurement of inventory that has now been sold and **unallocated production overheads and abnormal amounts of production costs of inventories**. The circumstances of the entity may also warrant the inclusion of other amounts, such as distribution costs. [**emphasis added**]" Therefore, Entity A is required to include the unallocated fixed overhead costs and labour costs incurred while the factory was closed or operated significantly below normal capacity in COGS. This would result in a lower gross margin, all else being equal.

The Group's Discussion

Group members agreed with the analysis.

Some Group members commented that if an entity chooses to present the impact of COVID-19 separately from the COGS line item, it should also present separately all other material impacts of COVID-19 in other parts of its income statement. This will ensure that the income statement's presentation is balanced in highlighting material income and expenses directly attributable to the pandemic. One Group member observed that separating all material impacts of COVID-19 in the income statements may be difficult in practice when multiple financial statement line items are affected. In such cases, highlighting COVID-19's impact in COGS without also explaining its material impacts on other financial statement line items would not provide a complete picture of how the pandemic has affected the entity's financial performance.

Fact Pattern for Issue 4

- A manufacturing company has received $400,000 under the Canada Emergency Wage Subsidy (CEWS) program for the salaries and wages paid to its employees working in manufacturing and administration.[1] Specifically, $250,000 relates to salaries and wages paid to employees working in manufacturing and $150,000 relates to salaries and wages paid to employees working in administration.
- The company presents expenses by function. During the period covered by the CEWS, no inventory was produced and all salaries and wages relating to manufacturing were appropriately expensed and presented in "COGS." All salaries and wages relating to administration were expensed and presented in "Selling, general and administration".

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[1] CEWS is a grant program the government of Canada offers to compensate entities for continuing to pay salaries and wages to employees even if they are not providing active service due to COVID-19. To be eligible for the CEWS, an entity must have suffered a minimum revenue drop during the period March-July 2020. Subsequent to July 2020, there is no requirement for there to be a revenue drop to be eligible for the subsidy, however the decrease in revenue is factored into the calculation of the subsidy amount.

Issue 4: How should the company present CEWS received on its income statement?

Analysis

Paragraph 29 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* provides entities with a choice to present grants related to income as part of profit or loss, either separately or under a general heading such as "Other income" or alternatively as a deduction in reporting the related expense. Therefore, the company has a policy choice in how to present the income from the CEWS. The following table illustrates, depending on the IAS 20 policy choice elected, several potential approaches to presenting the grant income in the income statement where expenses are classified by function therein.

(Amount in thousands of Canadian dollars)		**After the CEWS grant**		
	Before the CEWS	**Approach #1:** present grant income adjacent to the related expenses	**Approach #2:** present grant income as a separate line	**Approach #3:** present grant income as a deduction from the related expenses
Revenue	$1,000	$1,000	$1,000	$1,000
Cost of goods sold	(300)	(300)	(300)	(50) (note (c))
Grant income	-	250 (note (a))		-
Gross profit	700	950	700	950
Other income	100	100	100	100
Selling, general and administration	(200)	(200)	(200)	(50) (note (c))
Grant income	-	150 (note (a))	400 (note (b))	-
Other expenses	(80)	(80)	(80)	(80)
Profit before income taxes	$520	$920	$920	$920

Note (a) – Grant income of $400 was recognized in the year, of which $250 is attributable to salaries and wages recognized in cost of goods sold, and $150 is attributable to salaries and wages recognized in selling, general and administration expenses.
Note (b) – Grant income of $400 was recognized in the year, which is attributable to salaries and wages paid to manufacturing and administration employees.
Note (c) – Grant income of $400 was recognized in the year. Cost of goods sold of $300 and Selling, general and administration expenses of $200, were reduced by grant income of $250 and $150 respectively attributable to salaries and wages included within those respective line items.

Please note: The above notes are meant to explain the line items in the above income statement and do not purport to be the full disclosures required when grant income is recognized in the financial statements. For such required disclosures, refer to paragraph 39 of IAS 20.

Under Approach #2 in the table above, different views exist in practice as to whether the grant income should be presented as part of "income from operations." Some think it should be presented within "income from operations" because the grant subsidizes an operating expense (i.e., salary and wages). Others note that paragraph 29 in IAS 20 permits grant income to be presented as "other income," which can be outside of "income from operations" as the grant is economic relief obtained as a result of a pandemic, which is not in the ordinary course of the entity's operating activities.

The Group's Discussion

The Group noted that IAS 20 provides an entity the choice to present grant income as part of profit or loss, either separately or under a general heading such as "other income" or alternatively as a deduction from the related expense. Therefore, they agreed that all three approaches are acceptable. They also thought that note disclosure for the grant income and the related expenses helps financial statement users better understand the impact of the grant on cash flows. One Group member highlighted that entities need to consider their past practice of presenting government grant income to ensure consistency with financial statement presentation before the pandemic.

Some Group members preferred Approach #3. They thought Approach #3 better reflects the net impact of COVID-19 after considering the associated grant income. One Group member thought Approach #2 provides the most distorted gross profit amount amongst the three approaches as it does not reflect the grant income attributable to COGS, resulting in a low gross profit.

The Group then discussed different alternatives as described in the analysis to present grant income as part of "income from operations" under Approach #2. Some Group members supported the view that grant income can be presented as part of "income from operations" as the grant is subsidizing an operating expense.

One Group member noted that paragraph 12 of IAS 20 states that the "government grants shall be recognized in profit or loss on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate." Therefore, this Group member commented that if inventory is produced in the period and the government grant is subsidizing the costs that are included in the cost of inventory, then the grants should be recognized in profit or loss in the same period as the inventories are sold and the associated COGS recognized.

Overall, the Group's discussion on Issues 1 to 4 raised awareness of the potential impact that COVID-19 may have on an entity's income statement presentation. No further action was recommended to the AcSB.

IAS 1: Application of paragraph 72A to classify a term loan as current or non-current

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

The amendments introduce changes to several paragraphs in IAS 1, including amending paragraph 69(d) and adding paragraph 72A (see changes below):

69 An entity shall classify a liability as current when:

(d) it does not have ~~an unconditional~~ the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period ~~(see~~

~~paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification~~.

72A An entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs 73-75, must exist at the end of the reporting period. If the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. **The entity must comply with the condition at the end of the reporting period even if the lender does not test compliance until a later date.** (**emphasis added**)

When the IASB issued the amendments to IAS 1, it also added paragraphs BC48A and BC48D to the Basis for Conclusions:

BC48A Paragraph 69(d) specifies that, to classify a liability as non-current, an entity must have the right to defer settlement of the liability for at least twelve months after the reporting period. In January 2020, the Board amended aspects of this classification principle and related application requirements in paragraphs 73–76. **The Board made the amendments in response to a request to reconcile apparent contradictions between paragraph 69(d)—which required an 'unconditional right' to defer settlement—and paragraph 73—which referred to an entity that 'expects, and has the discretion, to' refinance or roll over an obligation** [**emphasis added**].

BC48D The Board considered whether an entity's right to defer settlement needs to be unconditional. The Board noted that rights to defer settlement of a loan are rarely unconditional—they are often conditional on compliance with covenants. **The Board decided that if an entity's right to defer settlement of a liability is subject to the entity complying with specified conditions, the entity has a right to defer settlement of the liability at the end of the reporting period if it complies with those conditions at that date.** Accordingly, the Board:

(a) deleted the word 'unconditional' from the classification principle in paragraph 69(d);
and,

(b) added paragraph 72A to **clarify that if an entity's right to defer settlement is subject to compliance with specified conditions**:

(i)the right exists at the end of the reporting period **only if the entity complies with those conditions at the end of the reporting period**; and

(ii)**the entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date.**

[**emphasis added.**]

The Group considered the following fact pattern and discussed the impact of paragraph 72A of IAS 1 on classifying a loan in interim financial statements when a covenant test is not required under the contractual terms of the lending arrangement at the interim balance sheet date.

Fact Pattern

- Entity Y has a December 31, 20x3 year-end and is currently preparing its June 30, 20x3 interim financial statements in accordance with IAS 34 *Interim Financial Reporting*.
- Entity Y has a long-term bank loan that will be repayable in five years with a loan covenant specifying that the bank has the right to demand repayment immediately if Entity Y does not maintain a specified debt-to-equity ratio at each calendar year-end.
- The contractual terms of the bank loan stipulate that the bank will assess Entity Y's compliance with this covenant based on the audited financial statements. Entity Y's management must provide the audited financial statements by March 31 of the following calendar year.
- No conditions in the loan agreement apply as at June 30, 20x3. Therefore, Entity Y's compliance with this covenant will not be assessed by the bank as at June 30, 20x3.

Issue: How should Entity Y classify the bank loan in its interim financial statements when the covenant test is not required under the contractual terms of the loan?

View A – Entity Y should perform the covenant test as at June 30, 20x3 and classify the liability accordingly

Proponents of this view acknowledge that the bank loan cannot be due on demand as at June 30, 20x3 regardless of the result from the covenant test performed on that date. This is because contractually, the compliance with the covenant is based on the December 31, 20x3 figures. However, they note that amended paragraph 69(d) of IAS 1 requires a liability to be classified as current when an entity does not have the right at the end of the reporting period to defer settlement for 12 months. Furthermore, paragraph 72A of IAS 1 and paragraph BC48D in the Basis for Conclusions on IAS 1 are clear that the right to defer settlement must exist as at the end of the reporting period, even if the lender does not test compliance until a later date. The right to defer payment, proponents argue, exists only if Entity Y complies with the covenant test as at June 30, 20x3.

Therefore, Entity Y should perform the covenant test as at June 30, 20x3. If it fails the covenant test, the bank loan would be classified as current, even though the loan is not contractually due on demand.

View B – Entity Y should perform the covenant test as at December 31, 20x3 as specified in the loan agreement and classify the loan as non-current at June 30, 20x3

Proponents of this view think that the contractual terms only give the bank the right to demand repayment if Entity Y fails the covenant test at each calendar year-end. The bank does not have a contractual right to demand prepayment of the loan and the borrower does not have a contractual obligation to settle the liability on June 30, 20x3. Therefore, proponents of this view think applying View A to classify the loan as current does not reflect the contractual rights and obligations that are agreed to between the contracted parties.

Therefore, Entity Y would classify its bank loan as non-current as at June 30, 20x3 because it is not due for repayment in the next 12 months.

The Group's Discussion

Group members thought that the guidance in paragraph 72A of IAS 1 is unclear, such that both View A and View B might be appropriate.

Despite the lack of clarity, most Group members preferred View B. They thought that Entity Y has no condition to be complied with on June 30, 20x3 because the lending agreement only stipulates that the covenant be measured on December 31, 20x3. Thus, no covenant applies on June 30, 20x3 and the result from the covenant test performed on that date is irrelevant to the classification of the loan. Furthermore, some Group members were concerned that the outcome from applying View A (i.e. classify the loan based on the covenant test as at June 30, 20x3) may not faithfully represent Entity Y's financial position on June 30, 20x3. They considered a scenario where Entity Y is in a cyclical business with most sales occurring in the last quarter of the year. Applying View A could result in Entity Y failing the covenant at June 30, 20x3 although the entity is tracking to comply with the contractually required covenant test to be measured at December 31, 20x3. Under View A, Entity Y would classify the entire loan as current, even though there is no contractual test that applies on June 30, 20x3 and it expects to comply with the test at the year end. Group members thought that this outcome inaccurately portrays Entity Y's economic condition as at June 30, 20x3 to financial statement users as no actual breach of covenant occurred on that date. Some Group members further commented that classifying the loan as current as at June 30, 20x3 also reduces the usefulness of the information reported to financial statement users as it alerts them to a problem that does not yet exist, or may never exist, given the covenant will only be tested on December 31, 20x3. One Group member observed that this classification outcome can have consequences, such as triggering other default clauses or violating debt covenants in other lending agreements. This Group member noted that the effort to monitor the compliance and to renegotiate contracts can be significant to an entity.

Some Group members acknowledged that View A appears to be supported by a literal reading of paragraph 72A. They also thought that paragraphs BC48D and BC48E in the Basis for Conclusions to IAS 1 support that the right to defer settlement for 12 months must exist as at the end of the reporting period, even if the lender does not test compliance until a later date. One Group member also thought that if the covenant is close to being breached during the year, the entity should use professional judgment and consider providing disclosures about the potential covenant breach and the mitigating action taken by management. A few Group members noted that in the fact pattern presented, the covenant is only required to be tested at a point in time. They thought that if the covenant is required to be complied with continuously, View A is more appropriate. Therefore, these Group members highlighted the importance for borrowers to have a clear understanding of the nature and frequency of covenant tests in loan agreements.

Several Group members then highlighted some practical challenges an entity may encounter under View A. One Group member noted paragraph BC48E in the Basis for Conclusions to IAS 1 does not prescribe a method to assess the compliance with a future covenant. As such, at June 30, 20x3, Entity Y may combine its financial projection for the rest of the year with its actual results year-to-

date to assess its year-end covenant compliance. This Group member observed that classifying the loan as current vs non-current based on the result of a future covenant test is a change from current practice. Another Group member noted that in practice, many covenants in loan agreements are non-financial, such as a requirement to have the financial statements audited. This Group member thought that these types of non-financial covenants may not be met in the interim period which will result in the loan always being classified as current under View A. Finally, one Group member pointed out that View A will lead to a disconnect with the contractual maturity analysis disclosure requirement in IFRS 7 *Financial Instruments: Disclosures* which specifies that the entity should disclose the contractual maturities of its derivative and non-derivative financial liabilities.

Given the potential impact that paragraph 72A may have on the classification of term loans and its significant consequences to borrowers, Group members thought that further clarification from the IASB on applying this paragraph, such as through publications of educational materials or illustrative examples would be helpful. As a result, they recommended that this issue be discussed with the AcSB to determine whether it should be raised to the IASB.

IAS 19: Change to discount rate method

One acturial assumption that has a material effect to the defined benefit obligation is the discount rate. The current discount rate method developed by the Canadian Institute of Actuaries (CIA method) was extablished in 2016.[2] The market turbulence brought by the COVID-19 pandemic has highlighted some vulnerabilities with the current method. To overcome these challenges, the CIA proposes a new recommended method to calculate the discount rate.

The Group discussed some accounting implications to provide inputs to the CIA's new recommended methodology considerations.

Discount rate guidance in IAS 19 Employee Benefits

Paragraphs 83 and 86 of IAS 19 provide the following guidance on selecting the market yield and estimating the discount rate for longer maturities:

> 83 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to **market yields at the end of the reporting period on high quality corporate bonds.** For currencies for which there is no deep market in such high-quality corporate bonds, the market yields (at the end of the reporting period) on government bonds denominated in that currency shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.
>
> 86 In some cases, there may be no deep market in bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such cases, an entity uses current market rates of the appropriate term to discount shorter-term payments,

2 The CIA method represents one approach for establishing the discount rate, other methodologies may be applied by actuaries.

> and **estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve**. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available corporate or government bonds.
>
> [**emphasis added.**]

IAS 19 does not define high quality corporate bonds. AA or AAA rated corproate bonds have been used in practice to determine the discount rate. Due to the long term nature of pension payments, extrapolation from the market curve is necessary to match the estimated maturity of the benefit payments that will be incurred far in the future.

Current CIA Method and its challenges

Established in 2016, the current CIA method relies only on high-quality bonds, such as AA rated corporate bonds and Canadian provincial and federal government bonds.

The long maturity discount rates are extrapolated using the AA rated corporate bond curve by maintaining the ratio of “X/Y”:

> X= spread between corporate AA bonds with five to ten years maturity over the government of Canada yield curve
> Y= spread between provincial bonds with five to ten years maturity over the government of Canada yield curve

The above ratio of spreads is used to individually adjust provincial bonds in the long term (10+ years) to create synthetic corporate AA bonds.

The Canadian bond market and recent market turbulence from COVID-19 have created some challenges in applying the current CIA method, such as:

a) A decreasing number of AA-rated corporate bonds in Canada since 2009.
b) Currenty, excluding hospital and university bonds and trasportation bonds, there are no AA-rated corporate bonds with a maturity over 10 years in Canada.
c) Market turbulance in March 2020 has caused a significant widening of spreads, causing the synthetic corporate AA curve to exceed the actual corporate A curve. To resolve this counterintuitive result, the synthetic corporate AA curve has been adjusted to not exceed the actual corporate A curve since March 2020.

Proposed CIA Method

The proposed CIA method introduces a “corridor approach” to ensure that the synthetic corporate AA curve stays in between the corporate A curve and provincial bond curve. Because the corporate A curve is not considered “high quality” in practice, it is not used directly to calculate the discount rate. Instead, it is used to indirectly extract market information in estimating the corporate AA curve.

The CIA is considering several technical and modelling decisions such as the definitions of “A” and “AA”, “corporate”, and “mid-term”. Back testing is also being performed by the CIA.

Accounting considerations for the proposed CIA Method

A few of the accounting considerations for the proposed CIA method include:

1. Are only AA or higher rated bonds considered as “high quality corproate bonds” when applying guidance in IAS 19?

In its November 2013 agenda decision, the IFRS Interpretations Committee (IFRIC) observed that “IAS 19 does not specify how to determine the market yield on HQCB [high quality corporate bonds], and in particular what grade of bonds should be designated as high quality. The Interpretations Committee considers that an entity should take into account the guidance in paragraphs 84 and 85 of IAS 19 (2011) in determining what corporate bonds can be considered to be HQCB.”

In addition, IFRIC noted that “high quality” as used in paragraph 83 of IAS 19 reflects an absolute concept of credit quality and not a concept of credit quality that is relative to a given population of corproate bonds. Therefore, the concept of what is high quality should not change over time.

2. Is it acceptable to use market information contained in A rated bonds as one of the inputs used to extrapolate the AA curve?

3. Should an average or best rating be used to determine an A or AA rating?
   - In practice, best rating has been used historically and reflects that at least one recognized rating agency consdiers the bond to be of that quality.

4. Should certain segments such as ports and airports be excluded when constructing the yield curve?
   - Ports and airports have been excluded historically when constructing the corporate bond yield curve under the CIA method as some think they are quasi-government.

5. Should the change in the CIA method be accounted as a change in estimate or a change in accounting policy?

The Group’s Discussion

The Group provided the following inputs to the five questions listed above:

1. Are only AA or higher rated bonds considered as “high quality corproate bonds” when applying guidance in IAS 19?

Group members commented that although IAS 19 does not specify what grade of bonds should be designated as “high quality”, in practice, it includes only AA or higher rated bonds. They further noted that as described in the November 2013 IFRIC agenda decision, “high quality” reflects an absolute concept of credit quality and not a concept of credit quality that is relative to a given population of corproate bonds. Therefore, they thought that the decreasing number of AA-rated corporate bonds in Canada should not cause a change in current practice as to what grade of corporate bonds should be considered as high quality.

2. Is it acceptable to use market information contained in A rate bonds?

Given that A rated bonds are only used to indirectly extract market information and are not directly used to derive the discount rates, Group members thought it is acceptable to use market information contained in them.

3. Should an average or best rating be used to determine A or AA rating?

Group members thought that it is important to have consistency in determining bond ratings. Therefore, the reason for a change in practice should be clearly explained.

4. Should certain segments such as ports and airports be excluded when constructing the yield curve?

Group members thought that the rationale of considering ports and airports as quasi-government agencies and excluding these entities when constructing the corporate bond yield curve, should be clearly articulated. One Group member commented that the reason for exclusion should not simply be predicated on the typically low yield of these bonds as this rationale alone is not sufficient. In addition, such rationale being the only reason for exclusion would inappropriately bias, based on yield, the population of bonds used in the model.

5. Should the change in CIA method be accounted as a change in estimate or a change in accounting policy?

Group members thought that the proposed CIA method is refining the current method to derive a better estimate based on updated market information. Therefore, they thought the change should be accounted for as a change in estimate.

Overall, Group members highlighted that an entity should apply the model used consistently and any changes made to the model used should be supported and documented in the context of IAS 19's best estimate requirements.

The purpose of the discussion is to provide inputs to the CIA's proposed method. No further action was recommended to the AcSB.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

Push-down Accounting and Accounting for Asset Acquisition

At the May 2020 meeting, the Group recommended the AcSB consider suggesting the topics of push-down accounting and accounting for asset acquisitions be considered by the International Accounting Standards Board (IASB) as part of its 2020 Agenda Consultation.

The AcSB discussed this issue at its July 7, 2020 meeting and agreed to consider including these two topics when it deliberates its response to the IASB's 2020 Agenda Consultation, in addition to other possible items that will be considered.

OTHER MATTERS

Reminders on IASB® Documents for Comments

General Presentation and Disclosures (Primary Financial Statements)

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

Goodwill and Impairment

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

Lease Liability in a Sale and Leaseback

The IASB has decided to propose a narrow-scope amendment to IFRS 16 *Leases*, specifying how a seller-lessee should apply the subsequent measurement requirements in IFRS 16 to the lease liability that arises in the sale and leaseback transaction. The IASB plans to publish the exposure draft in November 2020. Stakeholders are encouraged to monitor this issue and submit their comments to the IASB.

PRIVATE SESSION

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

IASB – Documents for Comments

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

- IASB Discussion Paper, "Business Combinations—Disclosures, Goodwill and Impairment"