IFRS Discussion Group

Report on the Public Meeting

September 10, 2015

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board (AcSB) regarding the identification of 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 a summarized version of the Group's discussions during the meeting. For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips[*].

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

Items Presented and Discussed at the September 10, 2015 Meeting

IAS 19: Annuity Buy-ins

IAS 38: Cloud Computing Arrangements

IAS 7: Disclosure of Interest in the Statement of Cash Flows

IAS 21: Determining Functional Currency

IAS 21 and IAS 39: Translation of a Monetary Asset in an Economy with Multiple Exchange Rates

IAS 21 and IAS 39: Translation of an Equity Investment and Impairment Considerations

IFRS 9: Effective Interest Rate

IAS 12 and IAS 34: Income Tax Expense for Interim Periods

IFRS 3 and IAS 12: Uncertain Tax Positions Acquired in a Business Combination

Update on Previous Items Discussed by the Group

IAS 23: Impairment

IAS 33: Escrow Share Arrangements

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[*] Due to technical difficulties, some of the audio quality is poor and, at times, may not be audible.

IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

IFRS 3: Various Issues

IAS 1: Classification of Long-term Debt to Be Repaid from an Offering

Other Matters

IFRS 3: Business Combinations

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ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

IAS 19: Annuity Buy-ins

Some entities are looking into ways to de-risk their obligations relating to defined benefit plans. In some cases this is achieved by entering into an annuity contract with an insurance entity. Under such contracts, an entity is able to reduce or, in some cases, eliminate the uncertainty associated with the defined benefit obligation.

Annuity contracts may be “annuity buy-in” contracts or “annuity buy-out” contracts. An annuity buy-in may include a conversion feature that enables conversion to an annuity buy-out.

An annuity buy-in is when a pension plan pays a lump-sum amount to an insurance company that includes a premium to compensate the insurer for the risk transfer and also administration fees. The insurer will pay to the pension plan an amount equal to the benefit payments that are due to the plan beneficiaries. The pension plan will then use the funds to pay the benefit payments as legally the obligation is still within the plan.

An annuity buy-out is similar to an annuity buy-in, except that the insurer will take over the responsibility for the benefit payments to be made to the plan beneficiaries. The pension plan is no longer responsible for making benefit payments. Depending on the contract, and the provincial or federal benefit regulations that the pension plan is governed by, the entity may or may not retain some residual risk.

The accounting treatment of annuities requires consideration of several aspects of the guidance in IAS 19 *Employee Benefits*. For example, an entity needs to consider whether the annuity transaction is a settlement, if it meets the definition of a plan asset, and whether the amount and timing of the benefit payments exactly match those of the obligation to which the annuity relates.

Fact Pattern:

An entity is the sponsor of a defined benefit pension plan. The plan is closed to new entrants and is comprised entirely of retirees. The plan enters into an annuity buy-in contract. Other facts are as follows:

- The amount paid to the insurer for this contract is $120 million and the present value of the related obligation to which this contract relates is $100 million.
- The transaction does not meet the definition of a settlement.
- The annuity buy-in contract meets the definition of a qualifying insurance policy (and as such is a plan asset).
- The payment stream that will be generated by the annuity exactly matches the amount and timing of the benefits payable under the plan. When benefit payments fall due, the insurer will pay the benefits due to the plan, which in turn uses these funds to pay the plan beneficiaries.
- Administration costs are assumed to be nil.

Issue 1: What is the appropriate accounting for this transaction in the financial statements of the sponsoring entity under IAS 19?

Paragraph 115 of IAS 19 applies in this instance because the annuity has been identified as a qualifying insurance policy. Paragraph 115 of IAS 19 states:

> “Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).”

In this fact pattern, the annuity will initially be recognized at $120 million (i.e., the transaction price) but there will be a day one entry to reduce the value of the plan asset to $100 million (i.e., the present value of the related obligation). On a go forward basis, any remeasurements of the obligation will be exactly matched by the remeasurements of the qualifying policy in order to comply with the requirements of paragraph 115 of IAS 19. The remeasurements will net to zero, there will be no interest income given the net pension position is equal and offsetting, and there will be no current service cost as the plan is comprised entirely of retirees. IAS 19 does not specify how the day one entry of $20 million should be dealt with.

View 1A – The day one entry should be recorded in profit or loss.

This view draws an analogy to the guidance on settlement accounting and records the day one entry in profit or loss.

View 1B – The day one entry should be recorded in other comprehensive income.

Under this view, the transaction relates to a change in the value of a plan asset. Therefore, the day one entry should be treated as a remeasurement that is recorded in other comprehensive income.

View 1C – There is an accounting policy choice to record the day one entry in either profit or loss, or in other comprehensive income.

An accounting policy choice exists on how to record the effect of all annuity transactions of the same type.

The Group's Discussion

Most Group members supported the view that the day one entry should be recorded to other comprehensive income (View 1B) because specific criteria have to be met in order to qualify for settlement accounting. Therefore, it may be difficult to support an analogy to a settlement, especially given the fact pattern described.

One Group member commented that it is important to understand the substance of the transaction to determine the appropriate accounting (for example, consider whether the annuity buy-in was part of a series of linked transactions leading to a settlement of the plan obligation). Another Group member also noted that the fact pattern needs to be assessed to determine if the risk has been transferred from the plan sponsor to the insurer and whether this change has been communicated to plan members. One Group member supported the view that there is an accounting policy choice (View 1C) and noted that both approaches are seen in practice.

Issue 2: If the annuity buy-in included an option to convert to an annuity buy-out, would the appropriate accounting on Issue 1 change?

View 2A – No.

As stated under the first issue, IAS 19 does not provide specific guidance on these transactions. This additional feature would not affect the accounting treatment of the day one entry.

View 2B – Yes.

The substance of the annuity buy-in with an option to convert to an annuity buy-out is a settlement. Although the obligation and asset would still exist on a gross basis (albeit netting to zero), the day one entry should be recorded through profit or loss to best reflect the economics of the transaction.

View 2C – Further analysis would be required.

The facts and circumstances would need to be assessed to determine whether the nature of the transaction is substantively different from other annuity buy-ins. Factors to consider may include whether the annuity buy-out constitutes a settlement, there is any cost associated with the conversion, and the buy-out conversion is foreseen or planned.

The Group's Discussion

Most Group members supported the view that further analysis would be required because the specific facts and circumstances should be considered (View 2C). One Group member observed that in most provinces, the plan sponsor retains responsibility even if an annuity buy-out is purchased to de-risk a defined benefit plan obligation. Similar to the previous issue, most Group members thought it may be difficult to support an analogy to a settlement. However, one Group member pointed out that an amount that is recorded in other comprehensive income does not get recycled back into profit or loss

according to the requirements in IAS 19. Therefore, if the intent of the transaction was to achieve a settlement of the plan obligation, the facts and circumstances would need to be closely examined to determine the appropriate accounting.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 38: Cloud Computing Arrangements

There are various types of cloud computing arrangements in the market place. The following are some common examples:

- Software as a service – This arrangement is a software distribution model where applications are hosted by the service provider and the purchaser has access to the software through a network. The customer maintains all infrastructure and hardware.
- Platform as a service – This arrangement is a model where the cloud provider delivers both hardware and software tools needed for application development. The provider hosts the hardware and software such that the customer does not need to perform installation or purchase in-house hardware and software. This model does not replace the full infrastructure of the customer's needs.
- Infrastructure as a service – This arrangement is a model where virtualized computing resources are provided over the internet. The third party provider hosts the hardware, software, servers, storage and other components on behalf of its users.

Outside of a software license being included in an arrangement, there are other types of possible fees for cloud computing. For example, there could be fees for service, software upgrades, support and maintenance, and internal and external consulting services. Other costs may include website development, development or acquisition of software to be used by the customer, infrastructure purchases and contract acquisition costs. These fees may be bundled together as one fee or individually quoted by the supplier. For example, a monthly fee may include upgrade rights and support and maintenance services.

IFRSs do not contain explicit guidance about a customer's accounting for fees paid in a cloud computing arrangement. However, IAS 38 *Intangible Assets* contains the criteria for recognizing an intangible asset.

Issue 1: When does a cloud computing arrangement with a software license meet the criteria to be capitalized as an intangible asset?

View 1A – Capitalize the fees when the three criteria (i.e., identifiability, control over a resource and existence of future economic benefits) in IAS 38 are met.

Under this view, assuming that the arrangement results in future economic benefits flowing to the entity, the other two IAS 38 criteria of identifiability and control could be met if the arrangement includes certain characteristics. Examples of such characteristics could include the purchaser has a contractual right to take possession of the underlying software at any time during the service period without

significant penalty and the purchaser is able to run the software itself or contract another party to run the software.

When the arrangement meets the specified criteria in IAS 38, the software license component of the fees should be capitalized. Otherwise, it should be expensed as a service fee.

If components of both models (i.e., platform as service and software as service) were integrated into an arrangement, the hardware and infrastructure elements would be accounted for in accordance with IAS 16 *Property, Plant and Equipment*.

View 1B – Expense all fees.

This view considers that since IAS 38 is not explicit in stating that cloud computing costs qualify as an intangible asset, the fees should be accounted for as a service contract and expensed.

The Group's Discussion

Group members observed that cloud computing arrangements are becoming more common in practice and noted that IFRSs do not have specific guidance in this area like U.S. GAAP. Group members agreed that if the criteria in IAS 38 are met, the software license should be capitalized as an intangible asset (View 1A). However, there could be multiple elements in the arrangement (for example, training costs) and, thus, identifying what components exist is important to determine the appropriate accounting. Therefore, in addition to considering whether any amounts should be capitalized in accordance with IAS 38 (or IAS 16 depending on the nature of the element), guidance in IFRIC 4 *Determining whether an Arrangement contains a Lease* should also be considered to determine whether lease accounting would apply.

In addition, a cloud computing arrangement may not fit into a specific standard and, thus, entities may need to look at the *Conceptual Framework* to determine whether there is an asset in the arrangement. Entities should focus on identifying whether there is a right to use something rather than just looking at the underlying aspect of the software. If the definition of an asset is met, an entity would need to consider what type of asset the arrangement creates (for example, prepaid, other asset, or intangible asset). One Group member observed that upfront payments are sometimes paid to a third party rather than the cloud provider itself and this fact could have an effect on the accounting treatment as well.

Issue 2: From a customer's perspective, how should fees incurred to enter into a cloud computing arrangement be accounted for (assuming there is no software license element in the arrangement)?

View 2A – Analogize to existing IFRSs that recognize the costs incurred to obtain benefit over multiple reporting periods should be expensed over time.

There is existing guidance in IFRSs (for example, IAS 17 *Leases*) that would support recognizing these costs over the period of future benefit if an analogy can be made.

View 2B – Analogize to development costs and apply the criteria in paragraph 57 of IAS 38 to assess whether the costs should be capitalized.

Although there is no software license element to the arrangement, certain costs relate to development costs such as upfront website development or infrastructure costs.

View 2C – Expense as incurred.

The entire arrangement should be accounted for as a service arrangement and the costs expensed as incurred because there is no software license element.

The Group's Discussion

Some Group members thought that the accounting for the fees paid could be analogized to development costs, thus paragraph 57 of IAS 38 could be applied to determine whether the fees should be capitalized (View 2B). The rationale for this view is that guidance in IAS 38 appears to be more applicable to this situation and the costs incurred may have value that could be transferred or sold to another party.

Other Group members focused on first identifying whether there is an asset and, thus, struggled with applying View 2B. Several questions were raised in terms of whether there is a resource controlled by the entity and whether it is reasonable that the pattern of revenue recognition by the cloud provider could be different from the accounting treatment on the customer's side. In particular, one Group member commented that if it is appropriate for revenue to be recognized over time, it would seem reasonable for the customer to recognize the related cost over time as well. Also, similar to the view expressed under Issue 1, if the definition of an asset is met, an entity would still need to consider the nature of asset that has been acquired in order to determine the appropriate accounting treatment.

Overall, the Group's discussion raises awareness on some of the different types of cloud computing arrangements that are emerging in practice and the complexities involved in determining which standard applies. One Group member suggested that this topic could be revisited by discussing one or more specific fact patterns as each type of cloud computing arrangement could be vastly different. No further action was recommended to the AcSB at this time.

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

IAS 7: Disclosure of Interest in the Statement of Cash Flows

Paragraphs 31 and 32 of IAS 7 *Statement of Cash Flows* state:

> "Cash flows from interest and dividends received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.
>
> The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with IAS 23 *Borrowing Costs*."

Issue: Do interest received and paid have to be disclosed on the face of the statement of cash flows?

View A – Interest received and paid must be disclosed on the face of the statement of cash flows.

Under this view, paragraphs 31 and 32 of IAS 7 are explicit in noting that cash flows from interest received and paid shall be disclosed separately and on the statement of cash flows.

The words "disclosing separately" and "disclosed in the statement of cash flows" can be interpreted to indicate disclosure of these items is required on the statement of cash flows as opposed to in the notes to the financial statements.

View B – Interest received and paid can be disclosed either on the face of the statement of cash flows or as part of the notes to the financial statements.

Under this view, presenting interest received and paid in the notes to the financial statements meets the requirements in paragraphs 31 and 32 of IAS 7. Proponents of this view argue that IAS 7 is not explicit regarding when items must be disclosed on the face of the statement of cash flows or when disclosure in the notes to the financial statements is sufficient.

The Group's Discussion

One Group member supported that interest received and paid should be disclosed on the face of the statement of cash flows (View A). It is important for users to be able to identify the amount of interest paid and interest expense in order to perform calculations like the interest coverage ratio to assess an entity's solvency. Another Group member noted there are two variations to View A in disclosing the amount of interest received and paid; either disclosing separately within the cash flow activities (i.e., as part of operating, investing or financing activities) or disclosing as supplementary information immediately after the statement of cash flows.

Most Group members thought it is acceptable and just as effective to disclose the amounts either on the face of the statement of cash flows or as part of the notes to the financial statements (View B) as long as transparency is achieved. A few Group members observed the requirements in IAS 7 could be improved because the wording is not clear, particularly in considering borrowing costs because it would be difficult to comply when interest paid is part of both cash flows from operating and investing activities. Group members acknowledged that although there is diversity in practice in terms of how entities disclose cash flows from interest received and paid, the different approaches taken should not be a concern as long as the information is transparent in the financial statements for users to access.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 21: Determining Functional Currency

According to paragraph 8 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*, the functional currency of an entity is "the currency of the primary economic environment in which the entity operates."

Paragraph 9 of IAS 21 describes this to "normally be the one in which it primarily generates and expends cash" and outlines the factors to be considered.

Paragraph 10 of IAS 21 provides a listing of the factors that "may also provide evidence of an entity's functional currency." Paragraph 11 indicates that "additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity" and provides a listing of those factors.

Paragraph 12 of IAS 21 then states:

> "When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity's functional currency."

The guidance in paragraph 12 of IAS 21 might imply that if the functional currency is considered obvious after considering paragraph 9 of IAS 21, an entity may not need to consider the secondary factors in paragraphs 10 and 11 of IAS 21. However, the additional factors provided in paragraph 11 may be highly relevant for entities that are in the start-up phase (i.e., not yet generating revenue) or foreign operations carried out as an extension of their parent entity.

Issue: Do paragraphs 10 and 11 of IAS 21 always need to be applied when determining an entity's functional currency, if the functional currency is considered obvious after applying the guidance in paragraph 9 of IAS 21?

View A – Paragraphs 10 and 11 of IAS 21 do not need to be applied if an entity's functional currency is considered obvious after applying the guidance in paragraph 9 of IAS 21.

Paragraph BC9 in the Basis for Conclusions on IAS 21 states that "indicators in paragraph 9 are primary indicators for determining the functional currency and that paragraphs 10 and 11 are secondary." It goes on to state that "this is because the indicators in paragraphs 10 and 11 are not linked to the primary economic environment in which the entity operates but provide additional supporting evidence to determine an entity's functional currency."

Under this view, if an entity's functional currency is obvious from the primary indicators noted in paragraph 9 of IAS 21, then there is no requirement to consider any of the secondary indicators.

For an entity that has not yet generated revenues, priority would be given to factors noted in paragraph 9(b) of IAS 21, which states, in part, that "the currency that mainly influences labour, material, and other costs of providing goods or services". Factors in paragraph 9(a) of IAS 21 relating to the currency influencing the sales price for its goods and services would not be applicable in such a situation.

View B – Paragraphs 10 and 11 of IAS 21 should always be considered when determining an entity's functional currency. The hierarchy in paragraph 12 of IAS 21 (i.e., giving priority to paragraph 9 of IAS 21) is applied only after the factors noted in paragraphs 10 and 11 of IAS 21 have been considered.

Under this view, both primary indicators (i.e., paragraph 9 of IAS 21) and secondary indicators (i.e., paragraph 10 of IAS 21) must be considered by all entities. If the entity is a foreign operation, it must also consider the secondary indicators in paragraph 11 of IAS 21 based on paragraph BC6 in the Basis for Conclusions on IAS 21, which states that "it would be contradictory for an integral foreign operation that 'carries on business as if it were an extension of the reporting enterprise's operations' to operate in a primary economic environment different from its parent."

The indicators will carry different weight depending on an entity's specific facts and circumstances (for example, whether the entity is generating revenues). Priority is given to factors described in paragraph 9 of IAS 21 only when it is not obvious after considering all the factors described in paragraphs 9 to 11 of IAS 21.

The Group's Discussion

The majority of the Group members expressed a view on this issue and highlighted that there could be diversity in practice. This could be evident especially in circumstances when an entity has not started to generate revenue because IAS 21 is not explicit in addressing development stage entities.

Some Group members noted that if the entity's functional currency is obvious after applying paragraph 9 of IAS 21, the guidance suggests paragraph 10 would not need to be applied. However, when an entity is in the start-up phase, it would be difficult to conclude that the functional currency is obvious when one of the factors in paragraph 9 of IAS 21 does not apply. Other Group members thought it is important to look at all the indicators and assess whether the answer derived under paragraph 9 is still obvious. If the indicators are mixed, this result could suggest that paragraph 9 of IAS 21 has not been applied properly.

The Group also discussed whether to look at future-oriented factors when determining the functional currency. Some Group members observed that practice is mixed as guidance in IAS 21 is not explicit in this area. Future-oriented factors that may be relevant include:

- the time horizon of when revenues are expected to be generated; and
- the currency that the revenue is expected to be denominated in according to the business model of the entity when it becomes fully operational.

Considering the mining or oil and gas industries as examples, these factors are important because sometimes an entity in the start-up phase may have a business model to sell the assets once probable resources exist rather than to develop the property to achieve production. Other entities may have a business model that will generate revenue in a certain currency (for example, sell gold in U.S. dollars) that may be different from the currency of the expenditures in the start-up phase when the functional currency is being determined.

Some Group members pointed out that a related issue is determining when an entity would need to reassess its functional currency, and what the triggering event might be. Depending on how an entity interprets and applies the requirements in IAS 21, it could lead to a change in functional currency at a later stage, particularly with development stage entities.

In terms of paragraph 11 of IAS 21, Group members noted that this requirement needs to be applied if the entity is a foreign operation of a reporting entity. Several Group members pointed out that paragraph BC6 in the Basis for Conclusions on IAS 21 seems to conflict with the guidance in IAS 21. This paragraph indicates that it would be contradictory for an integral foreign operation to have a functional currency that is different from that of its parent, implying that paragraph 11 of IAS 21 can override paragraph 9 of IAS 21. These Group members questioned whether clarity is required in the Basis for Conclusions as opposed to the standard itself.

It was also pointed out that there is a viewpoint issued by CPA Canada's Mining Industry Task Force on IFRSs on determining functional currency to assist entities in applying the requirements in IAS 21.

The Group's discussion highlights that the application of paragraphs 9 to 12 of IAS 21 may be more complex for certain types of entities (for example, start-up entities) and that the standard does not explicitly take into consideration future-oriented factors. The Group recommended that the issue be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee.

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

IAS 21 and IAS 39: Translation of a Monetary Asset in an Economy with Multiple Exchange Rates

Certain foreign jurisdictions have implemented currency exchange controls that may affect the amount of cash and/or earnings that can be converted from the local currency. These foreign exchange controls may also determine or set the rate at which the local currency can be converted.

Venezuela is an example of such a jurisdiction that has implemented currency exchange controls.

Fact Pattern:

In February 2015, the Venezuelan government implemented two new official exchange rates that are intended to more closely reflect the actual market value of the Venezuelan Bolivar. As a result, Venezuela has a complex three-tier exchange rate system.

The first tier, the official exchange rate, is unchanged, and sets a rate of exchange to the U.S. dollar for settlement of U.S. dollar obligations related to preferential or essential goods, such as food and medicine, and services.

The new second tier, Supplementary Foreign Currency Administration System (SICAD), is a combination of the former second and third tiers (SICAD I and SICAD II) and sets a rate of exchange to U.S. dollars for non-essential goods.

The Marginal Currency System (SIMADI) is the third mechanism in the three-tier exchange rate system and allows for barter and legal trading of the Venezuela Bolivar. The introduction of this new exchange

mechanism represents an easing of the controlled exchange rates and a departure from the previous system that restricted access to foreign currency. Under SIMADI, businesses and individuals are allowed to purchase and sell foreign currency at the price set by the market.

Issue 1: When multiple exchange rates exist, which exchange rate should a reporting entity use to translate a monetary amount such as a foreign currency trade receivable?

IAS 21 *The Effects of Changes in Foreign Exchange Rates* provides guidance on translating a monetary item. Paragraph 21 of IAS 21 indicates that a foreign currency transaction shall be translated using "the spot exchange rate between the functional currency and the foreign currency at the date of the transaction." Paragraph 23(a) of IAS 21 then states that "at the end of each reporting period, foreign currency monetary items shall be translated using the closing rate." Paragraph 26 of IAS 21 states, in part: "When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date."

View A – An entity has an accounting policy choice as to which exchange rate to use.

Under this view, the official exchange rate is the exchange rate generally used. If an unofficial exchange rate exists, it may be possible to use depending on whether the unofficial exchange rate is used widely and legally for the purpose of the currency conversion. For example, the three published exchange rates could be considered to qualify as an "official" spot rate and thus, all three exchange rates could be available for use in translating the monetary asset.

Once an entity selects an exchange rate determination policy to translate monetary assets and liabilities, it continues to use that policy for all future periods in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

View B – Determining the appropriate exchange rate would depend on an entity's individual facts and circumstances.

Under this view, there are certain factors that an entity should consider in order to determine which exchange rate to use. For example:

- an entity's legal ability to convert currency or to settle transactions using a specific rate;
- its intent to use a particular foreign currency exchange, including whether the rate available through that exchange is published or readily determinable; and
- whether the supply of the reporting entity's currency is available and sufficient to cover the amount outstanding for immediate delivery.

Although multiple exchange rates exist, in many situations not all exchange rates are available to all entities.

The Group's Discussion

Group members supported the view that determining the appropriate exchange rate depends on an entity's individual facts and circumstances (View B). An entity does not have an accounting policy choice when there are multiple exchange rates available. The nature of the transaction, the ability to

exchange currency and other relevant factors should be closely examined to support which exchange rate to use. Even if there is a lack of exchangeability, an entity still needs to consider which rate to use for translation that would best faithfully represent the transaction. Group members observed that the IFRS Interpretations Committee's November 2014 agenda decision on foreign exchange restrictions and hyperinflation would support View B.

Issue 2: What is the effect, if any, on the valuation of the foreign currency trade receivable if the customer is willing and able to pay the outstanding balance but the local government restricts access to the funds due to foreign exchange controls?

IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity to assess, at the end of each reporting period, whether there is any objective evidence that a financial asset or group of financial assets is impaired. Paragraph 59 of IAS 39 provides guidance on assessing whether there is any objective evidence of impairment.

The Group's Discussion

Group members shared a common view that the timing of when cash would be received and the lack of exchangeability would be factors affecting the valuation of the foreign currency trade receivable. The time value of money should be considered in measuring the amount even though it is not necessarily related to the credit risk of the customer. One Group member pointed out that consideration should be given to whether part of the receivable balance should be classified as non-current given the delay in payment and that discounting to reflect the time value of money is different from impairment. Another Group member noted that paragraph AG8 of IAS 39 provides guidance on what is required in measuring the carrying amount of the financial asset. Group members also noted that if the foreign currency trade receivable is material to the entity, additional disclosure should be included to assist users in understanding how the transaction, other events and conditions are reflected in the financial statements. Another related issue that may be discussed at a future meeting is under what circumstances would an entity change from one exchange rate to another exchange rate due to a new foreign currency exchange system and how the change should be accounted for.

Overall, the Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 21 and IAS 39: Translation of an Equity Investment and Impairment Considerations

A reporting entity may hold an investment in an associate that operates and is located in a jurisdiction with currency exchange controls, and has deteriorating economic conditions. It is expected that such controls would affect the extent to which the cash and/or earnings of the associate could be repatriated to the reporting entity and, thus, affect the future cash flows to be received by the reporting entity from its investment.

A reporting entity would need to consider the effect of the currency exchange controls on the carrying value of the investment in an associate resulting from the translation of the associate's functional

currency to the reporting entity's functional currency. The entity would also need to consider whether there are any impairment effects.

Paragraph 8 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* defines a foreign operation as "an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity."

Paragraph 44 of IAS 21 requires that the financial statements of a foreign operation are "translated into the presentation currency of the reporting entity so that the foreign operation can be included in the financial statements of the reporting entity by consolidation or the equity method."

If the foreign operation has a functional currency of a hyperinflationary economy, the financial statements of the foreign operation must first apply the requirements in IAS 29 *Financial Reporting in Hyperinflationary Economies* before the requirements in IAS 21.

In terms of impairment considerations, IAS 28 *Investments in Associates and Joint Ventures* requires the application of IAS 39 *Financial Instruments: Recognition and Measurement* to determine whether it is necessary to test for an impairment loss. Paragraph 59 of IAS 39 provides guidance on assessing whether there is any objective evidence of impairment. Paragraph 61 of IAS 39 also states:

> "In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment."

Venezuela is an example of a jurisdiction that has implemented currency exchange controls.

Fact Pattern:

Before February 2015, Venezuela had three legal mechanisms to exchange currency, but not all exchange mechanisms and rates were available to entities. Those rates were known as the official rate, SICAD I and SICAD II. The official rate was for essential goods, SICAD I was used for specific authorized transactions, industries and business activities and SICAD II was intended to be the closest legal rate to a market-based rate. SICAD II converts 50 Venezuelan Bolivars to 1 U.S. dollar while the official rate converts 6.3 Venezuelan Bolivars to 1 U.S. dollar.

The reporting entity:

- has an investment in an associate, accounted for using the equity method, that was previously translated using the official rate in the prior year financial statements; and
- has determined that it should now be using SICAD II to translate the investment in the associate as a result of the introduction of this exchange rate.

This change results in a substantial decline in the carrying value of the equity investment.

Issue: Do the requirements of IAS 21 prevent a reporting entity from classifying such a decline in carrying value in profit or loss?

View A – Yes, recognition in profit or loss is not permitted.

Under this view, the decline in the carrying value of the investment in the associate from using SICAD II is considered an exchange difference. IAS 21 is clear on what foreign exchange related items should and should not be included in profit or loss. Such items do not include exchange differences from the translation of a foreign operation.

IAS 1 *Presentation of Financial Statements* indicates that the components of other comprehensive income include gains and losses from translating the financial statements of foreign operations.

View B – No, recognition in profit or loss is permitted.

Under this view, the decline in the carrying value of the investment in the associate from using SICAD II is more appropriately classified as an impairment loss and, thus, should be recognized in profit or loss.

The existence of exchange control mechanisms and the introduction of an exchange rate that more closely reflects market value of the local currency would be considered objective evidence of impairment according to IAS 39. This evidence would trigger an impairment test and the calculated impairment loss would be recognized in profit or loss.

View C – Recognition in profit or loss is not permitted but an impairment test is still required.

Under this view, the decline in the carrying value of the investment in the associate is an exchange difference and, thus, should be recognized outside of profit or loss. However, since the availability of U.S. dollars using the SICAD II exchange rate is limited, this fact would likely affect the timing and quantify of cash flows that ultimately flow to the reporting entity from its investment. Therefore, proponents of this view think that impairment indicators do exist and, thus, an impairment test is required.

The Group's Discussion

Most Group members supported the view that recognition in profit or loss is not permitted but an impairment test is still required (View C) because IAS 21 is clear that the effects of translating an investment in an associate should be recorded in other comprehensive income. The decline in the foreign exchange rate that resulted in a reduction to the carrying value of the investment in the associate that operates in a deteriorating economic environment would be considered an indicator of impairment. Therefore, an entity would need to test for impairment and, in some fact patterns, may also need to re-evaluate whether significant influence still exists such that the equity method of accounting remains appropriate.

One Group member noted that in a situation when there are no other impairment indicators (for example, the investment in the associate is very profitable), it may be difficult to solely consider the decline in the foreign exchange rate to be objective evidence that triggers a test for impairment (View A). This Group member also observed that guidance in U.S. GAAP is different compared to IFRSs and could result in recognition in profit or loss.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IFRS 9: Effective Interest Rate

The expected credit loss model in IFRS 9 *Financial Instruments* uses a dual measurement approach where the loss allowance is measured at an amount equal to either the 12-month expected credit losses (Stage 1) or the lifetime expected credit losses (Stages 2 and 3).

The stages are explained on page 16 of the IASB's Project Summary of IFRS 9:

- "Stage 1: As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established. This serves as a proxy for the initial expectations of credit losses. For financial assets, interest revenue is calculated on the gross carrying amount (ie without adjustment for expected credit losses).
- Stage 2: If the credit risk increases significantly and the resulting credit quality is not considered to be low credit risk, full lifetime expected credit losses are recognised. Lifetime expected credit losses are only recognised if the credit risk increases significantly from when the entity originates or purchases the financial instrument. The calculation of interest revenue on financial assets remains the same as for Stage 1.
- Stage 3: If the credit risk of a financial asset increases to the point that it is considered credit-impaired, interest revenue is calculated based on the amortised cost (ie the gross carrying amount adjusted for the loss allowance). Financial assets in this stage will generally be individually assessed. Lifetime expected credit losses are still recognised on these financial assets."

The distinction between Stages 2 and 3 is that under Stage 2, impairment is typically assessed on a collective basis, whereas under Stage 3, it is assessed on an individual basis.

The impairment measurement basis depends upon whether there has been a significant increase in credit risk since initial recognition. Generally, if there has been a significant increase in credit risk since initial recognition, then impairment is measured at lifetime expected credit losses. In Stages 1 and 2, interest revenue is calculated based on the gross carrying amount. Under Stage 3, interest revenue is calculated based on the amortized cost of the financial asset (i.e., the gross carrying amount adjusted for the loss allowance).

Paragraph 5.4.1 in IFRS 9 states:

> "Interest revenue shall be calculated by using the effective interest method (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:
>
> (a) purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.

(b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods."

Fact Pattern:

Assume that a loan has the following terms:

- a zero coupon and amount repayable at maturity of $1,000;
- a remaining maturity of two years; and
- an effective interest rate of 10 per cent.

The loan becomes credit impaired at the beginning of the period and the expected cash flows under the loan are $400.

At the beginning of the period:

- the gross carrying amount is $826 ($1,000 ÷ 1.1^2);
- the loss allowance for expected credit losses is $496 ($826 – $400 ÷ 1.1^2); and
- the amortized cost is $330 ($826 – $496).

The interest revenue for the period calculated under paragraph 5.4.1(b) of IFRS 9 would be $33 ($330 x 0.1).

Issue: How should the gross carrying amount and the loss allowance for expected credit losses on the financial asset be calculated at the end of the period when it has become subsequently credit-impaired (assuming there is no change in the expected cash flows)?

View A – Gross carrying amount is adjusted by the amount of interest revenue recognized during the period.

The wording in the definitions of the gross carrying amount, amortized cost and effective interest rate is considered to indicate that the gross carrying amount at the end of the period for credit-impaired assets is calculated as follows:

- the gross carrying amount at the beginning of the period; plus
- the interest revenue recognized for the period using the effective interest method.

The gross carrying amount is increased to $859 by the amount of interest revenue recognized of $33. Consequently, the amortized cost is $363 and the loss allowance is $496 ($859 – $400 ÷ 1.1), which is unchanged from the beginning of the period.

The resulting entry under this view would be a debit to gross carrying amount of $33 and credit to interest income of $33.

Under this view, the starting point for the calculation of the gross carrying amount is the amortized cost. Amortized cost is the asset's initial carrying amount plus or minus amortization using the effective interest method. The effective interest method is used for the calculation of interest revenue in profit or loss.

The adjustment to the amortized cost should be based on the interest revenue recognized under the effective interest method. The same adjustment applies to the gross carrying amount as the amortized cost is the starting period for the calculation.

Further, proponents of View A argue that under View B, the loss allowance for expected credit losses would change from $496 to $546 but there is no corresponding impairment loss recognized as a result of recognition of interest revenue on a net basis. This is inconsistent with the guidance in paragraph B5.5.33 of IFRS 9, which indicates that any adjustment to the loss allowance for expected credit losses is recognized in profit or loss as an impairment gain or loss.

View B – Gross carrying amount is not affected by the recognition of interest revenue changing from gross to net basis.

The amortized cost is the same under View A such that the adjustment is equal to interest revenue recognized (i.e., amortized cost is $363). However, the gross carrying value and the loss allowance for expected credit losses are adjusted by the unwinding of the discount rate to reflect the passage of time. Therefore, the gross carrying would be $909 ($1000 ÷ 1.1), which changed from $859. The loss allowance for expected credit losses would be $546 ($909 – $400 ÷ 1.1), which changed from $496.

The resulting entry under this view would be a debit to gross carrying amount of $83, credit to loss allowance of $50 and credit to interest income of $33.

Under this view, when an asset becomes credit impaired, there is no change to its gross maturity amount and, thus, there should be no change in the application of the effective interest method. The relevant definitions in IFRS 9 do not seem to imply that the calculation of gross carrying amount should change if the financial asset moves between Stages 2 and 3. Also, the method of how to measure the loss allowance for expected credit losses should not change as a result of calculating interest revenue on a net basis in Stage 3.

Proponents of this view argue that View A would create more issues for a financial asset that moves back to Stage 2 from Stage 3 when it is no longer credit-impaired because interest revenue would then be calculated based on the gross carrying amount. Thus, View B generally ensures a consistent application of the concepts of "gross carrying amount" and "loss allowance" across all financial assets, regardless of the stage the asset is in.

The Group's Discussion

Group members supported the view that calculation of gross carrying amount is not affected the by recognition of interest revenue changing from gross to net basis (View B). This view provides a better reflection of the contractual cash flows and more faithfully represents the credit risk associated with the financial asset. One Group member noted that the wording in the definitions of gross carrying amount

and amortized cost also does not seem to support View A because neither definition would imply the amount is adjusted by the amount of interest revenue recognized.

Another Group member observed there is more emphasis in IFRS 9 for moving between Stages 1 and 2, but less from Stage 3 to Stage 2 as there would be a higher hurdle to support doing so when a financial asset was considered credit impaired at one point. A few Group members also noted that there are global discussions on this issue. While one global firm has concluded that View B is the appropriate one, other global firms have not yet reached a conclusion.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 12 and IAS 34: Income Tax Expense for Interim Periods

The approach to income taxes in IAS 34 *Interim Financial Reporting* does not treat the interim period as a discrete period but rather requires the use of an annual effective tax rate approach. This approach is similar to the method used under U.S. GAAP, except that there are some explicit differences as well as certain areas where U.S. GAAP is more prescriptive. Some entities may choose to look towards guidance in FASB Accounting Standards Codification (ASC) 740, *Income Taxes*, when it is not in conflict with the more general requirements of IAS 34.

Paragraph 30(c) of IAS 34 states:

> "income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes."

The standard does not clearly distinguish between the accounting for current and deferred tax, referring only to "income tax expense" and does not provide detailed guidance in some areas.

The Group discussed six common issues in applying IAS 34 to income tax accounting.

Issue 1: What is meant by a taxing jurisdiction?

Paragraph B14 of the Illustrative Examples for IAS 34 states: "To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied to the interim period pre-tax income of each jurisdiction."

Questions arise around what is a "taxing jurisdiction" and whether this means:

- each separate tax-paying component (i.e., each entity or group of entities that file under one tax return); or
- each of the entities or groups of entities in the same jurisdiction regardless of whether they file under one tax return.

Under U.S. GAAP, ASC paragraph 740-270-30-36 indicates when an entity is subject to tax in one or more jurisdictions, one overall estimated annual effective tax rate should be used to determine the

interim period tax (benefit) related to consolidated ordinary income (loss) for the year-to-date period, except in certain situations. There is a view under U.S. GAAP that a taxing jurisdiction means an individual tax return if multiple tax returns are filed within the same jurisdiction and the tax provision or benefit resulting from those separate tax returns is determined without regard for the other tax returns.

Without detailed guidance in IAS 34, the question is whether there is an accounting policy choice in assessing what is a taxing jurisdiction and whether entities may look towards the guidance in U.S. GAAP.

The Group's Discussion

One Group member made a general observation that some preparers in practice, possibly more so among smaller-sized entities, would consider the taxing jurisdiction to mean by legal entity and would calculate the interim tax expense in a manner consistent with what would be done at year end. The interim tax periods would be considered as a discrete period in order to reflect the tax effect for that period. However, another Group member commented that the approach described above may result in a material difference from what is required by IAS 34. For example, when there is a graduated tax system, treating each interim period as a discrete period would be considered incorrect under IAS 34 because the tax rate applied is based on the cumulative amount of income generated in the fiscal year rather than in the interim period. Therefore, an annual effective tax rate would take into account graduated tax rates. Another Group member also commented that in practice, larger entities with operations in many jurisdictions tend to apply the annual effective tax rate and not look at a jurisdiction by entity level.

Issue 2: What approach should be taken when an entity is unable to forecast a separate estimated average annual effective income tax rate for a certain jurisdiction?

If it is not practicable to apply either an average rate for each jurisdiction or a separate rate for each category of income, paragraph B14 of the Illustrative Examples for IAS 34 allows an entity to use a weighted average of rates across jurisdictions or across categories of income if this rate represents a reasonable approximation of the effect of using more specific rates.

Under U.S. GAAP, ASC paragraphs 740-270-25-3 and 740-270-30-18 contain explicit guidance in such situations. For example, if a category of income cannot be reliably estimated, then an entity accounts for the tax discretely in the period for which that category of income occurs but uses the annual effect tax rate approach for the other categories of income. However, the inability to make a reliable estimate of the annual effective tax rate generally only occurs in exceptional circumstances under U.S. GAAP.

Issue 3: What approach should be taken for near break-even accounting income projections and the effect of application of the annual effective tax rate?

In some situations (for example, involving a seasonal business), an entity may project a near break-even annual accounting income and a tax expense or recovery. However, there could be significant earnings (or losses) in interim periods and applying the projected annual effective tax rate according to IAS 34 could result in substantial interim tax expense (or recovery) that may reverse within a single fiscal year.

FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods – an interpretation of APB Opinion No. 28* considers such a situation. When minor changes in estimated annual ordinary income can have significant effects on the estimated annual effective tax rate, entities need to consider whether a reliable estimate of the annual effective tax rate can be made.

The Group's Discussion

The Group discussed Issues 2 and 3 together because the underlying question is what an entity should do if the annual effective tax rate cannot be reliably estimated. Without detailed guidance in IAS 34, the question is whether entities may look towards the approach used under U.S. GAAP.

A few Group members commented on these two issues. It was observed that in general, an entity can make a reliable estimate of the annual effective tax rate. Although in practice some entities may follow a similar approach to U.S. GAAP, the rationale should be supported by IAS 34. One Group member noted that U.S. GAAP has a high hurdle to account for an item discretely such that it would be rare to conclude the annual effective tax rate cannot be reliably estimated. Therefore, it would be difficult to support that the annual effective tax rate model cannot be applied.

Issue 4: What approach should be taken to account for enacted or substantively enacted changes in tax law?

IAS 34 does not clearly address how to account for enacted or substantively enacted changes in tax law nor clearly distinguish between current and deferred tax. Paragraph 29 of IAS 34 states, in part, that "the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements." Paragraph 47 of IAS 12 *Income Taxes* states: "Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period."

One possible approach could be to recognize the effect of the deferred tax remeasurement in full in the interim period during which the tax legislation is enacted or substantively enacted. Alternatively, since the annual effective tax rate approach in IAS 34 is not clearly distinguished from the measurement of deferred tax, another possible approach could be to include the change in the deferred tax asset or liability in the estimate of the effective income tax rate for the current year.

Under U.S. GAAP, ASC paragraph 740-270-25-5 provides guidance that states:

> "The effects of new tax legislation shall not be recognized prior to enactment. The tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year shall be recorded after the effective dates prescribed in the statutes and reflected in the computation of the annual effective tax rate beginning no earlier than the first interim period that includes the enactment date of the new legislation. The effect of a change in tax laws or rates on a deferred tax liability or asset shall not be apportioned among interim periods through an adjustment of the annual effective tax rate."

Issue 5: What approach should be taken to account for tax loss carryforwards existing at the beginning of the annual period?

Paragraph B21 of the Illustrative Examples for IAS 34 quotes the requirement from IAS 12 that for the carryforward of unused tax losses and tax credits, a deferred tax asset should be recognized "to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised." In assessing whether future taxable profit is available, the criteria in IAS 12 are applied at the interim date. If these criteria are met as at the end of the interim period, the effect of the tax loss carryforward is included in the estimated average annual effective income tax rate.

In recognizing a deferred tax asset in the above situation, two possible common approaches are that the estimate of the average annual effective tax rate:

- includes only those carried forward losses expected to be utilized in the current financial year and a separate deferred tax asset is recognised for those carried forward losses now expected to be utilized in future annual reporting periods; or
- reflects the expected recovery of all the previously unutilized tax losses from the beginning of the period in which the assessment of recoverability changed.

The approach under U.S. GAAP is generally consistent with the first approach described above.

Issue 6: What approach should be taken to account for changes in expectations regarding the outcome of uncertain tax positions?

There is no specific guidance under IAS 34 that prescribes how to account for the changes in an entity's evaluation of uncertain tax positions in an interim period.

Under U.S. GAAP, changes in judgment about tax positions taken in previous annual periods should be treated as discrete events in the period in which a change in judgment occurs. Changes in judgments about tax positions reflected in a prior interim period within the same fiscal year should be included in the estimated annual effective tax rate computation.

The Group's Discussion

The Group discussed Issues 4 to 6 together because the underlying question deals with whether an entity should blend changes in judgement to the annual effective tax rate or account for the entire tax effect in the interim period that the change in judgment arises. Without specific guidance in IAS 34 on each of the issues described below, the question is whether an entity has an accounting policy choice.

Two Group members commented on these three issues. It was acknowledged that IAS 34 is silent on accounting for changes in judgement related to changes in enacted or substantively enacted tax rate, estimates of realizing a deferred tax asset, and uncertain tax positions. U.S. GAAP has more prescriptive guidance that would account for such changes on a discrete basis. Those Group members supported that an accounting policy choice exists under IFRSs, at least for some of these circumstances, given that IAS 34 does not contain explicit guidance.

Overall, the Group's discussion was meant to raise awareness around the common issues in applying IAS 34 in the calculation of income tax in an interim period. No further action was recommended to the AcSB.

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

IFRS 3 and IAS 12: Uncertain Tax Positions Acquired in a Business Combination

The Group had previously discussed the issue of "Uncertain Tax Positions Acquired in a Business Combination" at its meeting on April 19, 2012.

The issue was whether to recognize and measure the uncertain tax position in accordance with the general recognition and measurement principles in IFRS 3 *Business Combinations* (i.e., at fair value) (View A) or in accordance with IAS 12 *Income Taxes* by virtue of applying the exception in paragraphs 24 and 25 of IFRS 3 (View B). At that time, some Group members supported each view while other Group members supported both views on the basis that an accounting policy choice exists.

Subsequent to the Group's discussion, the IFRS Interpretations Committee considered an issue with respect to the accounting treatment for uncertain tax positions relating to current tax. The IFRS Interpretations Committee discussed whether uncertain tax positions should be recognized in accordance with IAS 12 or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* At its July 2014 meeting, the IFRS Interpretations Committee's agenda decision indicated that uncertain tax positions relating to current tax are to be recognized under IAS 12 and not IAS 37.

Question: Does the IFRS Interpretations Committee July 2014 agenda decision affect the views expressed by the Group at its April 19, 2012 meeting?

View A of the April 2012 meeting report indicates that uncertain tax positions should be measured at their acquisition date fair values and paragraph 56 of IFRS 3 should be applied to subsequent measurement.

View A1 – Yes, the IFRS Interpretations Committee July 2014 agenda decision affects View A and clarifies that uncertain tax positions are to be recognized under IAS 12 and not IAS 37.

Under this view, it is not appropriate to apply paragraph 56 of IFRS 3 to subsequent measurement because this guidance is applicable only to amounts in the scope of IAS 37.

View A2 – No, the IFRS Interpretations Committee July 2014 agenda decision does not affect View A. It is still appropriate to apply the guidance in paragraph 56 of IFRS 3 by analogy.

Paragraph 46 of IAS 12 states:

> "Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period."

Given the uncertainty related to the amount and timing of the outflows and inflows of resources for uncertain tax positions and the lack of a more detailed measurement guidance in IAS 12, under this view, entities may look to the guidance in IAS 37 to help determine the "amount expected to be paid" under IAS 12.

Further, paragraphs 22 and 23 of IFRS 3 requires a lower threshold for recognition of contingent liabilities assumed in a business combination (i.e., contingent liabilities are recognized at fair value even if not probable). Since paragraph 56 of IFRS 3 addresses subsequent measurement and requires that a contingent liability be measured at the higher of the amount that would be recognized under IAS 37 and the amount recognized in the business combination, this approach would avoid any potential day one remeasurement issues. The same day one remeasurement issue could arise with an uncertain tax position. Applying the guidance in paragraph 56 of IFRS 3 by analogy to uncertain tax positions remains a reasonable approach.

View B – No, the IFRS Interpretations Committee July 2014 agenda decision does not affect the view that uncertain tax positions are subject to the IAS 12 recognition and measurement exception in IFRS 3.

View B of the April 2012 meeting report indicates that uncertain tax positions do meet the scope exception of paragraphs 24 and 25 of IFRS 3. The wording in paragraph IN9 of IFRS 3 implies that all assets and liabilities falling within the scope of IAS 12 are to be measured under IAS 12 and not at fair value. Therefore, this view is not affected by the IFRS Interpretations Committee July 2014 agenda decision.

The Group's Discussion

One Group member expressed a view that the intent of IFRS 3 was to exempt assets and liabilities falling within the scope of IAS 12. However, paragraphs 24 and 25 of IFRS 3 are not worded clearly to convey that effect. The IFRS Interpretations Committee's discussion on uncertain tax positions is a piece of circumstantial evidence and does not apply in the context of a business combination. Therefore, it would seem that the IFRS Interpretations Committee July 2014 agenda decision should not change the initial views held.

Another Group member noted that the IFRS Interpretations Committee July 2014 agenda decision only concludes that uncertain tax positions should be recognized under IAS 12. The Interpretations Committee is still working on a draft interpretation to address the measurement aspect and considering guidance in IAS 37. Hence, it would still be difficult to preclude the view that paragraph 56 of IFRS 3 can be applied by analogy such that the amount would be recognized in accordance with IAS 37.

Another Group member noted that the IFRS Interpretations Committee July 2014 agenda decision may not have a significant effect in practice because if the exception paragraphs of 24 and 25 of IFRS 3 were applied, this would result in recognizing and measuring uncertain tax positions according to IAS 12. However, given the difficulty to attain precision in measuring uncertain tax positions that arise either through the normal course of business or through acquiring in a business combination, a proxy amount for fair value is used. Since paragraph 46 of IAS 12 requires that current tax liabilities (assets) should be measured at the amount expected to be paid to authorities, entities might look to guidance in IAS 37 to help determine "the amount expected to be paid" in the absence of clear measurement principles in IAS 12.

Overall, Group members who expressed a view noted that it is too early to change any previous decisions made in accounting for uncertain tax positions acquired in a business combination based on the IFRS Interpretations Committee July 2014 agenda decision.

The Group considered whether to raise this issue to the IFRS Interpretations Committee given a draft interpretation on uncertainty in income taxes is expected to be published soon. However, a few Group members observed that this issue is about uncertain tax positions acquired in the context of a business combination and, thus, it is likely that the requirements in IFRS 3 need to be amended to provide clarity over what standard applies as opposed to interpreting IAS 12. The Group confirmed that this is still a prevalent issue in practice and recommended that the AcSB consider this issue, along with the other IFRS 3 issues that the Group discussed before, on what further actions can be taken.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 23: Impairment

At its June 2014 meeting, the Group suggested that the AcSB explore other avenues to raise awareness of this issue as it may be more prevalent among Canadian entities in the resource sector. The AcSB staff reported to the Group that the issue was brought to the attention of the Oil & Gas Industry Task Force on IFRSs and the Mining Industry Task Force on IFRSs to raise awareness. The Mining Industry Task Force updated its Viewpoint on Capitalization of Borrowing Costs to reflect the Group's discussion.

IAS 33: Escrow Share Arrangements

At its September 2014 meeting, the Group suggested that the AcSB consider what actions should be taken on this issue (for example, raising awareness through reaching out to the Oil & Gas Industry Task Force on IFRSs and the Mining Industry Task Force on IFRSs). The AcSB staff reported to the Group that the issue was brought to the attention of both Task Forces and they noted that while escrow share arrangements are evidenced in the mining industry, it is not sufficiently prevalent to warrant issuing a viewpoint.

IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

The AcSB staff reported to the Group that its September 2014 discussions on "Contingent Consideration in an Asset Purchase" and "Contingent Consideration in an Asset Sale" were shared with the staff of the IFRS Interpretations Committee in response to an outreach request. Information was requested on an issue relating to variable payments for separate acquisition of property, plant and equipment and intangible assets.

IFRS 3: Various Issues

The AcSB staff reported that in the AcSB's comment letter to the IASB's Post-implementation Review of IFRS 3 *Business Combinations*, the following three issues discussed by the Group were raised:

- IFRS 3, IFRS 13 and IAS 37: Asset Retirement Obligations Assumed in a Business Combination or Asset Purchase (June 2014);

- IFRS 3 and IFRS 13: Business Combinations with Consideration Including Shares Subject to Restrictions (September 2013) and
- IFRS 3 and IAS 12: Uncertain Tax Positions Acquired in a Business Combination (April 2012).

The IASB completed its post-implementation review project on IFRS 3 in June 2015. Based on its Report and Feedback Statement, the IASB decided research will be undertaken on four issues identified with high or medium/high significance. The AcSB staff noted that the three issues raised by the AcSB in its comment letter were not included in the research areas. Group members confirmed that the above three IFRS 3 issues are still a concern in practice and recommended that the AcSB consider other avenues to have these issues addressed (for example, the IASB's 2015 Agenda Consultation).

The AcSB staff also noted that the IASB has a research project on Provisions, Contingent Liabilities and Contingent Assets and the Group's discussion on the issue of asset retirement obligations assumed in a business combination or asset purchase was shared with the IASB project staff for consideration.

IAS 1: Classification of Long-term Debt to Be Repaid from an Offering

The October 2012 meeting report indicated that the AcSB had considered the Group's recommendation. The AcSB staff was directed to undertake further research and discuss the issue with the staff of the IFRS Interpretations Committee.

In December 2012, the AcSB staff met with the IASB's Director of Implementation Activities and discussed the issue regarding classification of long-term debt to be repaid from an offering. In addition, although not referring explicitly to this issue, the AcSB's comment letter to the Exposure Draft "Classification of Liabilities (Proposed Amendments to IAS 1)" called for a more comprehensive project that addresses the inconsistency between paragraphs 69(a) and 69(d) of IAS 1 *Presentation of Financial Statements*.

One Group member noted that many comment letters submitted to the Exposure Draft did not support the proposals and hoped that further clarity will be forthcoming. The Group confirmed the application issue of classifying long-term debt to be repaid in an offering is still an issue in practice, but recommended that the AcSB monitor the current and any future IASB projects on IAS 1 for a future opportunity to raise this issue again.

(For a full understanding of the discussions and views expressed related to the update on previous items discussed by the Group, listen to the audio clip).

OTHER MATTERS

IFRS 3: Business Combinations

In June 2015, the IASB announced the completion of its Post-implementation Review of IFRS 3 *Business Combinations* and published the Report and Feedback Statement. The review shows general support for the accounting requirements in the standard but identifies some areas where further research will be undertaken, including accounting for goodwill. The Group discussed the effect of this report on previous issues – refer to IFRS 3: Various Issues.

IFRS 15: Revenue from Contracts with Customers

In July 2015, the IASB confirmed a one-year deferral of the effective date for IFRS 15 *Revenue from Contracts with Customers* to annual reporting periods beginning on or after January 1, 2018. The IASB also published an Exposure Draft, "Clarifications to IFRS 15," to propose clarifications to, and transition relief for, IFRS 15. Stakeholders were encouraged to submit their comments to the IASB before the comment period deadline.

The FASB also confirmed the deferral of the effective date by one-year and published two Exposure Drafts to clarify the standard. The Exposure Drafts are about identifying performance obligations and licensing and principal versus agent considerations.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)

In August 2015, the IASB published an Exposure Draft, "Effective Date of Amendments to IFRS 10 and IAS 28," proposing to postpone accounting changes for associates and joint ventures until completion of a broader review. The proposed amendment defers the effective date until the IASB has finalized amendments, if any, resulting from its research project on the equity method. Stakeholders were encouraged to submit their comments to the IASB before the comment period deadline.

The amendment addresses how an entity should determine any gain or loss it recognizes when assets are sold or contributed between the entity and an associate or joint venture and should have been effective at the same time as *Accounting for Acquisitions of Interests in Joint Operations* (amendments to IFRS 11 *Joint Arrangements*).

Preparers were reminded that the amendments to IFRS 11, effective for annual reporting periods beginning on or after January 1, 2016, add new guidance that clarifies IFRS 3 *Business Combinations* is to be applied by the acquiring entity that gains joint control over a joint operation that constitutes a business. This new guidance may result in a significant change in practice. It also clarifies that if an entity acquires an additional interest in a joint operation but still retains joint control, IFRS 3 is applied to the additional interest but the previously held interest is not remeasured.

The IFRS Interpretations Committee is working on a request to clarify whether a previously held interest in the assets and liabilities of a joint operation is remeasured to fair value when the investor's acquisition of an additional interest results in the investor becoming a joint operator (i.e., assuming joint control) in the joint operation. Stakeholders were encouraged to follow the status of this issue.

IASB Agenda Consultation

In August 2015, the IASB issued a Request for Views "2015 Agenda Consultation" seeking public input on the strategic direction and overall balance of its future work plan from mid-2016 until mid-2020. Stakeholders were encouraged to submit their comments to the IASB before the comment period deadline.

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