Statute Barred Payables

Extract, IFRS® Discussion Group Report on the Meeting – June 20, 2019

Entities sometimes incur liabilities that they are unable to pay for a period of time. The unpaid amount may be subject to a statute of limitations that prevents creditors from taking further legal action against the entity. A statute of limitations is a law passed by a legislative body to set a maximum time after an event within which legal proceedings may be initiated. The unpaid amount may also be referred to as a “statute barred amount.”

Fact Pattern 1

- An entity was not able to raise sufficient funds and, therefore, had to cease its operations. The entity failed to file its 2011 financial statements and was delisted in 2012. At the time of delisting, the entity had no assets and accounts payable of $500,000.
- During 2018, an investor group revived the entity by investing $200,000 to obtain a controlling interest in the entity and paid fees to revive the entity’s reporting issuer status. At the end of 2018, the entity had cash remaining of $100,000, $100,000 current liabilities and $500,000 related to the 2011 accounts payable amount, and expenses of $200,000.
- In 2019, the entity completed a reverse acquisition with a private entity. The accounts payable of $500,000 in 2011 is considered material to the combined entity.
- The entity operates in a jurisdiction where a two-year statute of limitations period exists. No creditor has taken action related to the 2011 accounts payable amount between 2012 and current date.

Issue 1: Does the 2011 accounts payable amount that is statute barred represent a liability of the combined entity?

View 1A – No, a creditor is unable to take legal action to enforce collection of a statute barred amount. Therefore, the 2011 accounts payable amount is not considered a liability of the combined entity.

Under this view, a creditor cannot take legal action against the entity relating to the 2011 accounts payable amount because the two-year statute of limitations period has elapsed. Therefore, the amount is not considered a liability of the combined entity. The combined entity may need to obtain a legal opinion to support derecognition of the 2011 accounts payable amount.

View 1B – Yes, the extinguishment criteria in IFRS 9 Financial Instruments have not been met. Therefore, the statute barred amount is considered a liability of the combined entity.

Paragraph 3.3.1 of IFRS 9 states that “an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished — ie when the obligation specified in the contract is discharged or cancelled or expires.”

Under this view, the statute of limitations only affects the creditor's ability to take legal action. It does not mean that the combined entity has been released, or discharged, from its obligation to its creditor. Obtaining a legal opinion regarding the ability of a creditor to commence action is not adequate to support that the combined entity has been legally released from its obligation.

The Group's Discussion

Some Group members supported the view that the 2011 accounts payable amount is a liability (View 1B). A few Group members thought that there is merit to consider derecognition because of the statute of limitations' effect on the liability (View 1A).

For Group members who thought there is merit to derecognizing the liability, they noted that the creditor waived or forfeited its rights to the 2011 accounts payable amount by not acting before the statute of limitations period lapsed. Also, they thought that if the entity is not going to pay the statute barred amount, then derecognition seemed more reasonable than keeping it on the entity's books indefinitely. One member raised the question about how to apply the measurement guidance in IFRS 9 to statute barred financial liabilities. This member thought that if the amount of the financial liability cannot be enforced or demanded, then the financial liability may be carried at a nominal amount given the expected cash flows are likely far into the future.

For Group members who supported that the 2011 accounts payable amount remains recognized as a liability of the entity, several points were considered. While the statute of limitations period has lapsed, there is still uncertainty as to whether the entity will pay the outstanding balance because it may do so to continue working with the supplier or for other business reasons. Also, obtaining a legal opinion may not be sufficient to support derecognition because the opinion may not necessarily capture all the circumstances surrounding the 2011 accounts payable amount. For example, the previous management group could have made oral promises to its creditors about repaying the financial liability when capital is raised, which could be relevant to whether the amounts are in fact statute barred. As such, the lapse of the statute of limitations period did not seem enough to conclude that the entity has no obligation.

Some members shared that from an auditor's perspective, it is challenging to have full knowledge of all information relevant to determining whether the amount is in fact statute barred (e.g., any steps the creditor has taken to collect on the amount during the statute of limitations period). From an investor's perspective, the existence of a liability may influence its decision-making process. For example, some members thought that an investor may be more likely to invest in an entity with no liabilities and be more skeptical of investing in an entity with a significant amount of liabilities. If the liability was derecognized, an investor would not be aware of the liabilities in which the entity has not paid.

Paragraph B3.3.1 of IFRS 9 also provides guidance on when a financial liability is extinguished. In part, the paragraph refers to when the debtor is "legally released from the primary responsibility for the liability (or part of it) either by process of law or by the creditor." In this fact pattern, the question is what the words "by process of law" mean, such as whether there must be other actions taken by the entity before it is legally released from its obligations.

A few Group members also discussed how the nature of the contractual amount may have changed from a financial liability to a provision that is accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as a result of the claim period lapsing. These members thought that references to "contract" and "contractual" in paragraph 13 of IAS 32 *Financial Instruments: Presentation* refers to the "contract" and "contractual" were agreements enforceable by law. From that perspective, the amount is not contractual in nature because creditors are prevented from taking further legal action against the entity after statute of limitations period has lapsed. Furthermore, since there is uncertainty to the timing or amount of the liability that would be paid by the entity, the obligation is more akin to a provision than a financial liability.

Fact Pattern 2

- When a Canadian-dollar deposit account is held in Canada by a federally regulated bank or trust company, including authorized foreign banks, has been inactive for 10 years and the account owner has neither requested nor acknowledged a statement of account, the balance is considered to be an "unclaimed balance".
- According to the Bank Act, federally regulated banks and trust companies have a legal obligation to send written notification to the account owners after each of two, five and nine years of inactivity in Canadian-dollar deposit accounts. If such account owner does not respond to this communication, the balance is transferred to the Bank of Canada as an unclaimed balance at the end of 10 years. Unclaimed balances are transferred annually to the Bank of Canada on December 31, which acts as a custodian on behalf of the account owner. The Bank of Canada holds balances for either 30 years if the amount is less than $1,000, or 100 years if the amount is $1,000 or more, at which point balances are transferred to the Receiver General of Canada.
- Other types of unclaimed balances, such as U.S. dollar accounts, are not subject to the unclaimed balances provisions of the Bank Act.

Issue 2.1: When are unclaimed Canadian-dollar balances held by a federally regulated bank or trust company derecognized?

Analysis

Paragraph 3.3.1 of IFRS 9 applies. A federally regulated bank or trust company should derecognize unclaimed Canadian-dollar balances when it transfers the amounts to the Bank of Canada in accordance with the statutory requirement because, at this point, its obligation to the account owner has expired.

The Group's Discussion

Group members noted that for unclaimed balances, the account owner can only retrieve his or her funds from the Bank of Canada once the federally regulated bank or trust company has transferred the amount. Therefore, Group members agreed with the analysis above.

Issue 2.2: When are unclaimed foreign currency denominated balances owed by a federally regulated bank or trust company derecognized?

Analysis

Paragraph 3.3.1 of IFRS 9 applies. The federally regulated bank or trust company has not been released from its obligation or liability to the account owner. Therefore, the federally regulated bank or trust company cannot derecognize the unclaimed foreign currency denominated account.

The Group's Discussion

Group members agreed with the analysis above. One Group member observed that the Government of Canada is considering potential amendments to the Bank Act, which includes extending the process of unclaimed Canadian-dollar balances to include foreign-denominated accounts.[1] However at the time of the IDG meeting, the proposals are not yet law.

Overall, the Group's discussion of the issues highlights factors to consider around the application of the derecognition principles in IFRS 9 related to financial liabilities affected by legislation. No further action was recommended to the AcSB.

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

[1] June 2018 – Modernization of the Unclaimed Balances Regime and Proposals for an Unclaimed Pension Balances Framework