IFRS® Discussion Group

Report on the Public Meeting

December 17, 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 DECEMBER MEETING

IAS 1: Classification of Debts with Covenants as Current or Non-Current

At its September 2020 meeting, the Group discussed the application of paragraph 72A of recently amended IAS 1 *Presentation of Financial Statements* (effective from 1 January 2023). The issue identified is how to determine whether a borrower has the right to defer settlement when a long-term liability is subject to a covenant and the borrower's compliance with the covenant is tested at future dates after the end of the reporting period.

The IFRS Interpretations Committee (the Interpretations Committee) discussed this issue at its December 2020 meeting. In the IFRIC agenda paper, the staff from the IFRS Foundation illustrated this issue using three scenarios. In each scenario, an entity has a loan that is repayable in five years. The loan is subject to a working capital ratio covenant that must be greater than a certain threshold and is due on demand if this ratio is not met. The three scenarios presented in the IFRIC agenda paper are as follows:

	Case 1	Case 2	Case 3	
Required working capital ratio	above 1.0	above 1.0	above 1.0	above 1.1
Testing date	each 31 December, 31 March, 30 June, and 30 September	each 31 March	31 December 20X1	30 June 20X2 and each 30 June thereafter
Conditions at 31 December 2X1 (the reporting date)	Working capital ratio is 0.9	Working capital ratio is 0.9	Working capital ratio is 1.05	
	The entity obtains a waiver for the breach before 31 December 20X1. The waiver is for three months. The entity expects the working capital ratio to be above 1.0 at 31 March 20X2 (and the other testing dates in 20X2).	The entity expects the working capital ratio to be above 1.0 at 31 March 20X2.	The entity expects the working capital ratio to be above 1.1 at 30 June 20X2.	

(Source: IFRS Interpretations Committee, Agenda Paper 2 (December 2020), page 5)

In all three cases, the staff from the IFRS Foundation thought the entity is required to classify the loan as a current liability because it does not have the right at the end of the reporting period to defer settlement of the loan for at least 12 months after the reporting period. They also concluded that an entity's expectation that it will meet the condition to be tested after the reporting period does not affect this assessment. Therefore, to be classified as non-current on December 31, the future working capital ratio covenants required for the next 12 months need to be met as at the December 31 reporting date, even though:

(a) non-compliance on December 31 was waived by the lender (see Case 1);

(b) compliance with the test is not required on December 31 (see Case 2); and

(c) the required test on December 31 is met but is followed by a more stringent test within 12 months that is not met on December 31 (see Case 3).

At its meeting, the Interpretations Committee generally agreed that the staff's conclusions reflected appropriate interpretation of the amended guidance as applied to those three scenarios. Interpretations Committee members also found the examples to be helpful to their understanding of the effects of the amendments.

The Interpretations Committee agreed that a tentative agenda decision should be published, substantially as proposed by the staff. The tentative agenda decision presents the three scenarios described above and summarizes the Interpretations Committee's rationale for concluding that the loans should be presented as a current liability in all three cases. It also reports the Interpretations Committee's tentative conclusion that principles and requirements in IAS 1 provide an adequate basis for determining the appropriate accounting in the three cases and its tentative decision not to add a standard-setting project to the work plan.

Considering the Interpretations Committee's recent discussion on December 1, 2020, the Group continued its discussion on the issue at this meeting. Specifically, Group members discussed whether the guidance in IAS 1 and the tentative agenda decision can be applied consistently to fact patterns that differ from the three scenarios described in the tentative agenda decision. In addition, the Group discussed challenges entities may face when implementing the guidance in IAS 1 and the tentative agenda decision.

Applying IAS 1 and the tentative agenda decision to a debt covenant that is related to financial performance as opposed to financial position

Fact Pattern for Issue 1

This fact pattern is similar to the fact pattern described in Case 3 in the IFRIC agenda paper, except:

(a) Instead of working capital ratio being the covenant, the covenant that must be met is based on a 12-month rolling earnings before interest, tax, depreciation and amortization (EBITDA). The EBITDA covenant must be measured at the entity's December 31 year-end and at each quarter end.

(b) The covenant requires that the company maintain EBITDA on a rolling 12-month basis as follows:

- At each of December 31, 20X3 and March 31, 20X4, the 12-month EBITDA should be at least $10 million.
- At each of June 30 and September 30, 20X4, the 12-month EBITDA should be at least $15 million.

(c) On December 31, 20X3, EBITDA for the last 12 months is $12 million and, based on the entity's budgets, the expectation is that EBITDA for the 12 months ended June 30, 20X4 is expected to be $17 million. The entity's budgeting process is subject to robust controls and the budget information is used for other accounting purposes, such as evaluation of impairment under IAS 36 *Impairment of Assets*.

Issue 1: How should the entity classify the loan on its balance sheet as at December 31, 20X3?

View 1A – The loan may be classified as non-current

- Proponents of this view refer to paragraph BC48E of the Basis for Conclusions to IAS 1 and think it explains that the standard permits the entity to make some adjustments when evaluating its compliance with future covenants as at December 31, 20X3. As noted in paragraph BC48E, the IASB decided not to specify how to make such an adjustment but it seems possible that there may be alternative methods that could result in different conclusions as to whether the future test could be considered to be met at December 31.
- Proponents of this view acknowledge that it differs from the Interpretations Committee's conclusion to classify the debt as current for Case 3 in the IFRIC agenda paper. However, they note that paragraph BC48E specifically addresses financial performance tests which are different than the financial position tests described in Case 3 in the IFRIC agenda paper.

View 1B – The loan would be classified as current

- Proponents of this view think the requirements in paragraph 72A of IAS 1 are clear that the covenant tests to be performed in the next 12 months must also be met as at the reporting date. If these future tests are not met at the reporting date, then the entity cannot demonstrate that it has the right to defer settlement beyond 12 months from the reporting date.
- Proponents of this view also note that the Basis for Conclusions is not part of the IFRS Standard. In addition, paragraph BC48E is likely referring to circumstances in which an entity's actual performance up to the end of the reporting period reflects a shorter period of performance than specified in the covenant (e.g. the actual EBITDA for nine months and a covenant requiring a 12-month rolling EBITDA). Thus, paragraph BC48E does not address the situation described in the fact pattern.
- As a result, based on the 12-month rolling EBITDA measured on December 31, 20X3, the future covenant requirements as at June 30 and September 30, 20X4, are not met. The loan should be classified as current as at December 31, 20X3.

View 1C – The guidance in IAS 1 is unclear and different interpretations are possible

- Proponents of this view note that the guidance in IAS 1 and in paragraph BC48E of the Basis for Conclusions to IAS 1 are unclear and inconsistent, which can result in different interpretations and inconsistent application.

The Group's Discussion

Group members who expressed a view supported View 1C, noting that the interaction between paragraph 72A of IAS 1 and paragraph BC48E in the Basis for Conclusions to IAS 1 is unclear, which could result in different interpretations and inconsistent application.

Group members acknowledged that the three cases included in the tentative agenda decision bring some clarity in the application of IAS 1 to financial position-type covenants. However, some Group members thought that the applicability of the tentative agenda decision is limited, because it does not address covenants relating to financial performance conditions or those relating to both financial position and financial performance conditions. One Group member noted that, although the working capital requirement in Case 3 of the IFRIC agenda paper relates to the entity's financial position, the more stringent requirement later in the year incorporates the entity's expected future performance. Another Group member raised a similar example for a covenant based on equity and thought that in assessing the compliance with such covenant, the entity may need to incorporate its future financial performance. These Group members thought additional examples illustrating how to distinguish between financial position and financial performance covenants would be helpful to improve consistency in application of the amendments.

Some Group members also noted that paragraph BC48E does not specify the adjustment method or the situations in which some adjustments are inappropriate. As a result, alternative methods can be applied to two identical loans, which could result in different conclusions as to whether the future covenant test could be met as at the reporting date. These Group members questioned whether the different accounting outcomes provide useful information to financial statement users.

A few Group members expressed concern that, without any further changes to IAS 1, View 1B may be the only acceptable view based on how paragraph 72A of IAS 1 is currently worded, even though many would believe that View 1A provides a more relevant and faithful representation of the entity's obligation to repay the loan.

Applying IAS 1 and the tentative agenda decision to non-financial covenants

The Group then discussed how the amended IAS 1 should be applied to non-financial covenants such as the requirement to file audited financial statements and the requirement to complete reserve reports by companies in the extractive industries.

The Group's Discussion

Some Group members noted that the guidance in IAS 1 and the tentative agenda decision is unclear on how the principles in IAS 1 should be applied to non-financial covenants. They compared Case 2 in the tentative agenda decision, which requires testing of a working capital ratio on a future date to a scenario where an entity is required to file audited annual financial statements. If the principle applied to arrive at the decision to classify the loan as current in Case 2 is applied to this non-financial covenant, then the loan would also need to be classified as current because the financial statements

will not have been audited as at the financial reporting date. Considering that it is common for loan agreements to include non-financial covenants that will be satisfied at future dates, these Group members were concerned that entities will need to classify all outstanding loans as current. They also thought this outcome does not provide an accurate depiction of the financial position of the entity to financial statement users.

Other challenges entities may face when implementing the guidance in the amended IAS 1 and the tentative agenda decision

Some challenges entities may face when implementing the guidance in IAS 1 and the tentative agenda decision include:

- The need to evaluate compliance with future covenants is inconsistent with how lenders will be testing the covenants. For example, in Case 2 in the IFRIC agenda paper, where the covenant is tested only once per year on March 31, the accounting standards are establishing the need to test at December 31, even though the lender did not design the test to be done at that time. Thus, the accounting requirement seems to negate the will of the parties to the loan agreement and what they agreed to with respect to the timing of the test.
- To continue to classify debt as long term, the borrower may need to ask the lender to waive their rights to call the debt in response to covenant breaches that might occur in the 12 months after the reporting date. Lenders may not be willing to do this.
- Seasonality may affect how the covenants are designed and could be the reason, for example, why in Case 3 the June 30 covenant test required a higher working capital ratio than was required at December 31. The accounting guidance seems to go against these practical considerations and may penalize seasonal businesses based on how the covenants are designed.
- The borrower's balance sheet can become more volatile when the classification of its debt changes frequently. For example, in Case 3 in the IFRIC agenda paper, the balance sheet on December 31, 20X3 will show the debt as current (even though the required test at that date is met) only to be reclassified to non-current if the entity meets its expectation to pass the more stringent test on June 30. Some might question the relevance of such reclassification, especially when the borrower was never technically in breach of a covenant.
- The financial statements may not clearly distinguish whether the loan is classified as current because the borrower has breached the loan covenant as at the balance sheet date or because the borrower may breach a covenant that is to be tested at a future date. Furthermore, the balance sheet could lead to the expectation that a payment will be made in the next 12 months, which may be inconsistent with other disclosures, such as those related to liquidity and the entity's ability to continue as a going concern.
- Classifying the loan as current can have business impacts if it causes covenants on other debts or contractual arrangements to be breached. One might question if this is appropriate when the debt reclassification to current is related to a future test, especially one that the entity is not likely to fail.

The Group's Discussion

Group members agreed with the challenges noted above when implementing the guidance in IAS 1 and the tentative agenda decision.

Some Group members noted that under Case 2 described in the IFRIC agenda paper, the borrower would have difficulties to obtain a waiver from the lender on the covenant that does not, per the loan agreement, need to be tested at the financial reporting date. Furthermore, one Group member observed that by implementing the tentative agenda decision, borrowers may choose to renegotiate lending agreements and covenants with their lenders and that such process takes time and may be costly to both sides. This Group member noted that the efforts spent by the lender and borrower do not provide significant economic benefits to the borrower given they had expected the covenant to be met. One Group member observed that if the negotiation results in a less stringent covenant, the lender could see its risk increased in the loan and may want to be compensated through a higher interest rate, which can have a significant impact on the borrower's business.

Some Group members noted that classifying the loan as current will create 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. They thought this inconsistency may be counter-intuitive to the financial statement users. A representative from the Canadian Securities Administrators (CSA) commented that there are various securities legislative requirements for issuers and registrants to disclose their working capital balances, such as the management discussion and analysis (MD&A), the prospectus, and the rights offering circular. Classifying the loan as current without the expectation to have a cash outflow related to the loan within the next 12 months represents an inconsistency with the policy rationale that requires the working capital disclosure. As a result, when working capital does not reflect the expected cash outflows for the next 12 months, issuers may need to provide additional explanation and disclosures in their filings to explain this inconsistency to the readers of these filings.

Overall, Group members thought that the principles expressed in the IAS 1 amendments are difficult to understand. In addition, they questioned the relevance and usefulness of the financial information produced to classify the loan as current when the lender as at the financial reporting date, does not have the contractual right to demand repayment of the loan, nor is it expected to have that right in the next 12 months. Therefore, Group members thought additional clarifications on the IAS 1 amendments and the tentative agenda decision are needed to address these concerns. Considering that the issues discussed are likely to be even more significant to Canadian companies with quarterly financial reporting requirements, Group members strongly encouraged financial statement preparers and users to respond to the tentative agenda decision. The AcSB Chair also noted that the AcSB decided at its December 16, 2020 meeting to formally respond to this tentative agenda decision before the comment deadline of February 15, 2021 and will consider Group member's feedback when drafting its response letter. No further action was recommended to the AcSB.

Disclosure of COVID-19 Impacts

At its meetings in May and September 2020, the Group discussed certain COVID-19 financial reporting considerations and income statement presentation matters. As companies are preparing for their 2020 year-end financial statements, the Group discussed various annual reporting disclosure requirements related to COVID-19.

When preparing their financial statements, entities should consider both the entity-specific and the broad effects of COVID-19 arising from the negative impact on the global economy and major financial markets.

The Canadian Securities Administrators ("CSA") published in May 2020 a presentation titled "COVID-19: Continuous Disclosure Obligations and Considerations for Issuers." Key messages from this publication include the following:

(a) When preparing financial statements in an evolving and uncertain environment with imperfect information, issuers should use the best information available to make well-reasoned judgments.

(b) Issuers with similar circumstances may have different judgments based on the information available, which is why detailed entity-specific disclosure in an entity's financial statements is important.

(c) New information should be considered as it becomes available and judgments and estimates need to be updated. The disclosures of these estimates in the financial statements should be entity specific.

(d) Common areas that may be subject to significant judgment and estimation uncertainty include:

i. going concern assessments;

ii. impairment assessments;

iii. fair value calculations, government assistance, revenue recognition; and

iv. deferred tax recoverability.

Group members discussed COVID-19 impacts on various disclosure topics in an entity's financial statements. The Group's discussion did not address disclosures outside the financial statements, such as the management discussion and analysis. In addition, the topics the Group discussed are not exhaustive. Entities should consider their own circumstances when analyzing how COVID-19 affects financial reporting.

Topic 1: Significant judgments and estimates

Analysis

- COVID-19 has brought many uncertainties and has affected various aspects of an entity's operations. Depending on an entity's specific circumstances, the application of different IFRS Standards may require material judgments and involve significant uncertainties. Some key areas of judgments and estimates are related to going concern assessment, fair value measurement, impairment assessment, recognition of provisions, and expected credit loss (ECL) measurement. In this uncertain environment, entities should provide insights into the risks and uncertainties they are facing and the judgments they have made in the financial statements.

- The disclosure provided should distinguish between the following:

a. Significant judgments per paragraph 122 of IAS 1 *Presentation of Financial Statements*. These judgments are those apart from estimates made when applying an entity's accounting policies that have the most significant effect on the amounts recognized in the financial statements; and

b. Significant sources of estimation uncertainty per paragraph 125 of IAS 1 if the source of estimation uncertainty results in a significant risk of material adjustment to recognized assets or liabilities within the next financial year.

The Group's Discussion

Group members agreed with the analysis.

Some Group members commented that during their review of interim and annual financial statements, they observed that the extent of disclosures of significant judgments and estimates varied from general statements to more robust and entity-specific disclosures. One Group member commented that some companies disclosed all potential judgments that COVID-19 can impact without focusing on those judgments that are significant and providing detailed explanations. A CSA representative also observed that in practice, some disclosures only state that COVID-19 has impacted the entity's judgments and estimates. They noted that a list or general statement of risk does not provide financial statement users with an understanding of the information used by an entity when making the significant judgments and estimates in this uncertain environment. Therefore, to make the disclosure more useful, they encouraged the entity to provide specific disclosure on significant judgments made and assumptions associated with major sources of estimation uncertainty.

One Group member observed that one area of judgment includes whether an asset continues to be classified as held for sale when the sale may not be completed within one year. This Group member noted entities should consider guidance in paragraph 9 and Appendix B of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when there is an extension of the period required to complete a sale.

Some Group members also encouraged entities to consider providing the types of disclosures included in paragraph 129 of IAS 1 to help financial statement users understand the judgments that management makes about the sources of estimation uncertainty. These members thought that disclosure of the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation is particularly important to financial statement users in the COVID-19 environment.

Topic 2: Going concern and liquidity risk disclosures

Analysis

(a) Going concern

- COVID-19 may cause severe deterioration to an entity's economic conditions that could cast doubt on its ability to continue as a going concern. An entity is no longer a going concern if its management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so.

- Assessing an entity's ability to continue as a going concern requires judgment, especially during this uncertain time. Entities should consider:
  - COVID-19's effects on their operations;
  - the effectiveness of management's mitigation plans; and
  - assistance provided by governments and lenders.
- For some entities, management has applied significant judgment to determine that there are no material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern. In some of these situations, small changes to management's assumptions may result in the determination that there are material uncertainties that cast significant doubt about the entity's ability to continue as a going concern. In these close call situations, the IFRS Interpretations Committee noted in its July 2014 agenda decision that the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgments made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The Group discussed this topic during its May 2016 meeting.
- Events after reporting date may provide further information in making this assessment and are adjusting events under IAS 10 *Events After the Reporting Period*.

(b) Liquidity risk disclosure

- To mitigate liquidity risks caused by COVID-19, management may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers on debt covenants.
- IFRS 7 *Financial Instruments: Disclosures* requires entities to provide disclosures to reflect any significant changes in the entity's liquidity position and how it is managing the liquidity risk. These disclosures should be consistent with the assessment of the going concern assumption.
- IAS 1 requires an entity to make qualitative and quantitative disclosures regarding its objectives, policies, and processes for managing capital. When an entity changes its capital management policies in response to COVID-19, such as suspending its dividends, the entity should disclose this fact with the reason and the future plans (per paragraphs 134- 135 of IAS 1).

The Group's Discussion

Group members agreed with the analysis.

A CSA representative emphasized the need for management to consider the disclosure requirements of paragraph 122 of IAS 1 when small changes to assumptions used in their going concern assessment may give rise to the determination that there are material uncertainties that may cast significant doubt about the entity's ability to continue as a going concern. In such close-call situations, entities should disclose judgments made in concluding that there are not material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

A Group member commented that the factors to consider for government organizations may be different than those in private sectors. For a crown corporation classified as an agent of the Crown[1], the corporation's assets and liabilities are the assets and liabilities of the government. Therefore, factors such as the government's intention to provide cash infusion need to be considered when making the going concern assessment of an agent crown corporation.

Topic 3: Impairment assessment of non-financial assets

Analysis

- At its May 2020 meeting, the Group discussed COVID-19's impact on an entity's impairment assessment of non-financial assets.
- The entity should consider the requirements in IAS 36 on its impairment assessment of non-financial assets and provide detailed disclosures of the assumptions made, the supporting evidence and the impact of a change in the key assumptions. The extent of disclosures made depends on whether the carrying amount of an asset or cash generating unit (CGU) is recoverable and the amount to which that recoverable amount exceeds the carrying amount of the long-lived asset or the CGU. An entity may need to provide more extensive disclosure if the asset or the CGU is not recoverable or if its determination is subject to significant judgment and uncertainty and if reasonably possible changes to assumptions may result in its carrying amount not being recoverable.
- In addition, the entity may need to consider the level at which it provides these disclosures. For example, an entity with multiple CGUs should consider whether separate disclosure is needed for them. It may not be appropriate to combine CGUs for disclosure purposes and provide an average or a weighted average disclosure of assumptions made.

The Group's Discussion

Group members agreed with the analysis.

Some Group members considered the impairment assessment of non-financial assets to be one of the most significant judgments impacted by COVID-19. One Group member noted that even in cases where an entity concluded that its non-financial assets are not impaired, the disclosures of the assumptions used and the judgments applied are valuable to financial statement users to understand the rationale for not impairing non-financial assets. Another Group member commented that factors such as the extent and the longevity of COVID-19's impact, the degree of uncertainty caused by COVID-19, and whether the potential impact of that uncertainty is material to the financial statements are often considered when assessing the extent of disclosures to provide.

Topic 4: Financial assets and fair value measurement

Analysis

- Estimating the expected credit loss of financial assets is another focus area for many entities.

[1] Crown corporations are government organizations that operate following a private sector model, but usually have a mixture of commercial and public policy objectives. Crown corporations are directly owned by the Government of Canada and are established through legislation, letters patent, or articles of incorporation under the Canada Business Corporations Act.

The Group discussed the impact of COVID-19 on an entity's ECL model at its May 2020 meeting. The IASB also published educational material on the "Application of IFRS 9 in the light of the coronavirus uncertainty" in March 2020.

- IFRS 7 requires extensive disclosures around credit risk such as:
  - how the impact of forward-looking information has been incorporated into the ECL estimate; and
  - details of significant changes in assumptions made in the reporting period, and changes in the ECL that result from assets moving from stage 1 to stage 2
- The uncertainties presented by the current environment can also impact fair value measurements. Fair value measurements should reflect market participants' views and market data at the measurement date under the current market conditions. An entity should pay close attention to fair value measurements based on unobservable inputs (i.e. level 3 measurements). The unobservable inputs used should reflect how market participants would reflect the effect of COVID-19 in their expectations of future cash flows related to the asset or liability at the reporting date. In addition, when there is a range of possible fair value estimates, the entity should apply judgment to determine the point within the range that is most representative of the fair value in that circumstance.
- Given these impacts on fair value measurements, it is important for the entity to provide transparency about the techniques, key assumptions and inputs it used to determine the fair value, including the sensitivities by providing disclosures required by IFRS 13 *Fair Value Measurement*.

The Group's Discussion

Group members agreed with the analysis.

One Group member commented that for financial institutions, the ECL estimation process involves significant judgments. Furthermore, this Group member observed that banks have provided detailed disclosures associated with the ECL, such as:

- the impacts to the ECL model from COVID-19 and payment relief programs offered to customers from the government and the banks;
- the need for management overlay adjustments to address any limitation in the ECL model; and
- a sensitivity analysis on the ECL incorporating different levels of forecasts of key macro-economic variables and other inputs

Another Group member noted that entities that received credits for any cancelled tradeshows or corporate events, should assess whether the credit should be classified as a current or a non-current asset and whether any of these credits may be impaired.

Several Group members then observed a lack of disclosures in some financial statements regarding COVID-19's impact on the determination of fair value of financial assets, especially on unobservable inputs. One Group member also noted that the measurement and disclosure requirements in IFRS

13 apply to non-financial assets that are measured at fair value, such as investment properties under the fair value model and biological assets. Therefore, entities should ensure IFRS 13 disclosure requirements are met for these assets as well.

Topic 5: Other considerations

Analysis

- Other areas that may require additional disclosures include:
  - onerous contracts,
  - insurance recoveries,
  - lease modifications,
  - employee termination programs,
  - government assistance,
  - share based compensation performance conditions and modifications,
  - variable consideration and revenue recognition,
  - supplier based financing arrangements,
  - inventory cost allocations, and
  - hedging and probability of forecasted transaction occurring.

The Group's Discussion

Several Group members considered other factors that may require additional judgment and disclosures, such as disclosures of COVID-19's impacts on an entity's risk management activities.

One Group member noted that from a financial statement user's perspective, more transparent information helps in understanding the nature and magnitude of the impact COVID-19 on the entity. Better COVID-19 disclosures also help users assess whether the impact of COVID-19 is temporary or more permanent in nature so that they can adjust their financial forecast accordingly.

Overall, the purpose of the Group's discussion is to raise awareness about COVID-19 impacts on various disclosure topics in an entity's financial statements. Group members also noted other helpful COVID-19 resources from regulators[2] and the AcSB are available to help entities through the annual financial reporting process. No further action was recommended to the AcSB.

IFRS 9: Classification of Limited Recourse Capital Notes by the Holder

Under IFRS 9 *Financial Instruments,* holders of financial instruments should measure financial assets after initial recognition at:

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[2] CSA Presentation: COVID-19: Continuous Disclosure Obligations and Considerations for Issuers
U.S. Securities and Exchange Commission publication: CF Disclosure Guidance: Topic No. 9
European Securities and Markets Authority public statement: Implications of the COVID-19 outbreak on the half-yearly financial reports

(a) amortized cost;

(b) fair value through other comprehensive income (FVOCI); or

(c) fair value through profit or loss (FVTPL).

A financial asset is measured at amortized cost if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).

Contractual cash flows that are SPPI are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest.

Contractual features that introduce exposure to risks or volatility in the contractual cash flows unrelated to a basic lending arrangement, such as exposure to changes in equity or commodity prices, do not give rise to contractual cash flows that are SPPI.

For financial assets where the contractual cash flows are not SPPI, instruments are required to be subsequently measured at FVTPL irrespective of the objective of the business model in which they are held (unless they represent investments in equity instruments, and qualify for and are elected to be measured at FVOCI).

The Group considered the following fact pattern regarding Limited Recourse Capital Notes (LRCN) and discussed the application of the SPPI test to the LRCNs and their classification by the holder.

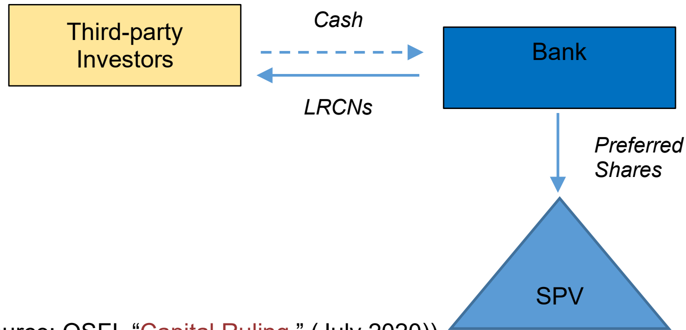
Fact Pattern

- LRCNs are a new form of financing issued by some financial institutions in Canada to institutional investors only. In July 2020, the Office of the Superintendent of Financial Institutions (OSFI)[3] released a Capital Ruling recognizing LRCN as Additional Tier 1 Capital.
- The LRCNs typically have two instruments:

1. A bond paying interest with a long maturity (typically 60 years); and
2. A perpetual non-cumulative preferred share (“preferred share”) the financial institution issued into a special purpose vehicle (SPV) for the benefit of the LRCN holders. Preferred shares have the same terms as the bond except they do not have a maturity date.

[3] OSFI is a Canadian independent federal government agency that regulates and supervises more than 400 federally regulated financial institutions and 1,200 pension plans to determine whether they are in sound financial condition and meet their requirements.

The following figure illustrates the LRCN structure:



(Source: OSFI, "Capital Ruling," (July 2020))

- When any of the following recourse event occurs, the sole remedy of the holders of the LRCNs is the delivery of the preferred shares from the SPV in exchange for the LRCNs on a one-to-one basis:
  (a) There is non-payment by the issuer of the principal amount of the LRCN, together with any accrued and unpaid interest, on the maturity date,
  (b) A failed coupon payment occurs,
  (c) In connection with the redemption of the LRCN, on the redemption date for such redemption, the issuer does not pay the applicable redemption price in cash, or
  (d) When OSFI announces the issuer is, or is about to become, non-viable or if the federal or a provincial government publicly announces that the issuer has accepted, or agreed to accept, a capital injection, or equivalent support, to avoid non-viability (non-viable contingent capital (NVCC) trigger event).

- Preferred shares are not redeemable at the option of holders and pay discretionary non-cumulative dividends. When a recourse event occurs that is also a NVCC trigger event, and the bonds are outstanding, then the preferred shares held by the SPV will be automatically converted into a variable number of common shares based on then trading price of the common shares subject to a floor price. The converted common shares will be automatically used to redeem the bonds of the holders.

Issue 1: Are the contractual cash flow from the LRCNs SPPI?

Analysis

- While the principal and interest payments of the bond component of LRCNs may appear to represent cash flows consistent with SPPI, the sole remedy of the non-payment is the delivery of the preferred shares from the SPV. Therefore, the principal and interest payments are not mandatory or legally enforceable because the Issuer can at its discretion convert the LRCNs into preferred shares instead of making interest or principal payments.

- In addition, LRCN holders should look through to the cash flows from the preferred shares to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. The dividends on the preferred shares are non-cumulative and are paid at the discretion of the Issuer's board. Furthermore, upon the NVCC trigger event, the holder will receive a variable number of common shares based on the then current trading price of the common shares subject to a

floor price, which exposes the holder's return to variability in the price of the issuer's common shares.

- The discretionary dividends on the preferred shares and the exposure to risks or volatility through the conversion to preferred and common shares are characteristics that are not consistent with a basic lending arrangement. As a result, the contractual cash flows from the LRCNs are not SPPI.

The Group's Discussion

Group members agreed with the analysis.

Issue 2: Is the FVOCI election available to the LRCN holders?

Analysis

- To determine whether an instrument held is eligible for the FVOCI election, IFRS 9 requires the holder to consider whether the instrument qualifies as equity in its entirety when viewed using the principles of IAS 32 *Financial Instruments: Presentation*.
- The LRCNs are made up of two components: financial liability and equity. The financial liability component represents the delivery of variable number of shares in the case of a NVCC trigger event. Since the LRCNs are not equity instruments in their entirety, they should be measured at FVTPL in their entirely as the FVOCI election is not available to the holders.

The Group's Discussion

Most Group members agreed with the analysis. One Group member considered the LRCN to be economically similar to NVCC preferred shares and noted that the Group discussed the holder's accounting for these preferred shares at its November 2016 meeting. Like the NVCC preferred shares, this Group member noted that from the issuer's perspective the instrument is not equity in its entirety. As such, the FVOCI election is not available to the holders.

The Group's discussion raises awareness about the holder's accounting for the LRCNs. No further action was recommended to the AcSB.

IAS 36: Impairment Test on Right-of-Use Assets

Under IFRS 16 *Leases*, lessees record right-of-use (ROU) assets and lease liabilities for most lease arrangements in their statement of financial position. The ROU assets are subject to the impairment requirements of IAS 36 *Impairment of Assets* and like other depreciable assets, a ROU asset is only tested for impairment when impairment indicators exist. If impairment indicators exist, an entity must determine whether the ROU asset can be tested on a stand-alone basis or whether it should be tested as part of a cash generating unit (CGU).

Per paragraph 22 of IAS 36, the first step in identifying the level at which the ROU asset should be tested for impairment is to look at whether it generates cash inflows that are largely independent of those generated from other assets or groups of assets in the entity. If this first condition is not met, an asset would still be tested at the individual asset level if either:

(a) the asset's individual fair value less costs of disposal (FVLCD) exceeds its carrying amount; or

(b) the asset's value in use can be estimated to be close to its FVLCD and the FVLCD can be measured.

In addition, if there is no reason to believe that an asset's value in use materially exceeds its FVLCD, the asset's FVLCD may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible

The Group considered the following fact pattern when an entity has decided to vacate a leased property and is vacating the property shortly after the decision date. The Group discussed impairment considerations for the ROU asset.

Fact Pattern for Issue 1

- Entity X recognizes a ROU asset for a building that it currently occupies as office space. The entity has occupied the building for seven years and has three years remaining on its original 10-year lease.
- Historically, this ROU asset has been tested for impairment as part of CGU 1 within Entity X since it was used by CGU 1 and did not generate largely independent cash inflows.
- During the COVID-19 pandemic, the office space is largely vacant as many employees are working from home. As a result, immediately prior to Entity X's year end of December 31, 2020, the entity's board, in conjunction with its management, made a final decision to permanently cease using this office space and has informed the affected staff. Entity X does not expect to be able to sublease the space given the location, relatively short remaining lease term and market conditions for office space.
- To facilitate the transition to other existing office spaces, Entity X will vacate the property two months after the final decision date. In accordance with paragraph 51 of IAS 16 *Property, Plant and Equipment*, Entity X reconsiders the ROU asset's useful life and residual value and changes its deprecation period prospectively to depreciate the remaining ROU asset's carrying value to nil over the remaining two-month period for which the space will continue to be used by CGU 1.
- Entity X considers its decision to cease use is an impairment indicator for the ROU asset on December 31, 2020, as it is considered an internal indicator of impairment under paragraph 12(f) of IAS 36.
- Assume that the recoverable amount of CGU 1 significantly exceeds its carrying amount and as such, no impairment is identified at the level of CGU 1.

Issue 1: Should the ROU asset, despite continuing to be used by CGU 1 for a two-month period before being vacated, be tested for impairment individually rather than as part of CGU 1?

View 1A – The ROU asset should be tested separately from CGU 1 when the decision to

vacate is made since CGU 1 generates largely independent cash inflows from the ROU asset given the short period of use until the property is vacated

- Proponents of this view note that given the office space is used by CGU 1 for only a short period, the cash inflows generated by the other assets making up CGU 1 are largely independent from the ROU asset. As such, the ROU asset should no longer be included in CGU 1 and should be tested for impairment separately. In addition, it would be inappropriate to shelter the impairment that exists in the ROU asset simply because the ROU asset is being used by CGU 1 for two months before the office is vacated.

View 1B – The ROU asset should be tested separately when the decision to vacate is made since it meets the exception described in paragraph 22(b) of IAS 36

- Proponents of this view acknowledge that the ROU asset does not generate cash inflows that are largely independent from other assets or groups of assets in Entity X. However, they also note that paragraph 22(b) of IAS 36 requires an entity to perform the impairment test on the individual asset level rather than as part of a CGU when the asset's value in use can be estimated to be close to its FVLCD and the FVLCD can be measured.
- In this fact pattern, Entity X has decided to vacate the office space. In addition, the period between the decision to cease using the property and the date when Entity X will vacate the property is very short. Therefore, proponents of this view think that the ROU asset's value in use can be estimated to be close to its FVLCD. Furthermore, the FVLCD of the ROU asset is assumed to be measurable. Given Entity X does not expect to be able to sublease the space, the FVLCD would likely be negligible.
- As a result, given the ROU asset's value in use can be estimated to be close to its FVLCD and the FVLCD is assumed to be measurable, the ROU asset should be tested separately when the decision to vacate is made.

View 1C – The ROU asset should continue to be tested as part of CGU 1 until the property is vacated and cannot be tested for impairment separately

- Proponents of this view note the fact pattern states that the ROU asset was not generating largely independent cash inflows. Furthermore, because the vacated space will not be subleased, the ROU asset will not generate any cash inflows after the property is vacated. They also note that even though the period is only two months, the property is still being used by CGU 1. Thus, it is not possible to reasonably determine that the cash flows from continuing use are negligible and that the value in use of the ROU asset approximates the FVLCD of the ROU asset.
- As a result, in accordance with paragraph 22 of IAS 36, Entity X should continue including the ROU asset in CGU 1 for the impairment test until the property is vacated.

The Group's Discussion

Most Group members thought that the ROU asset should be tested for impairment separately from CGU 1 and, therefore, supported either View 1A or View 1B. They noted that the ROU asset should

be impaired given the office space is largely vacant due to COVID-19 and that Entity X has decided to vacate.

Group members who supported View 1A noted the short period of time the ROU asset will be in use. However, these Group members thought that the longer the period the ROU asset will be in use, the more judgment will be needed to assess whether it should be tested as part of, or separately from, CGU 1.

Group members who supported View 1B considered that the ROU asset does not generate cash inflows that are largely independent from CGU 1 but that the exception in paragraph 22(b) of IAS 36 is met in the fact pattern. A few Group members did question whether the value in use of the ROU asset would approximate FVLCD. However, these Group members observed that the outcome under View 1A and View 1B is the same, but the technical analysis in arriving at the conclusion to test the ROU asset separately from CGU 1 for impairment is different.

A few Group members thought that it would be difficult to rule out View 1C given the judgment involved in the assessment. One Group member noted that paragraph 72 of IAS 36 indicates that CGUs should be identified consistently from period to period unless a change is justified. Therefore, a detailed analysis of the facts and circumstances would be needed to determine whether a change is justified.

Fact Pattern for Issue 2

- Same fact pattern as Issue 1 except Entity X has the ability and expectation to be able to sublease the ROU asset after vacating the property for the remainder of the lease.

Group members considered this fact pattern and discussed whether their views on Issue 1 will change.

The Group's Discussion

One Group member thought that the fact Entity X has the ability and expectation to sublease the ROU asset provides a stronger basis to support View 1A because the ROU asset can generate cash inflows that are largely independent of CGU 1. However, this Group member noted that an entity would need to be able to support its expectation of a sublease in order to incorporate the sublease income into the impairment test.

Another Group member continued to support View 1B even though the entity has the ability and expectation to sublease the ROU asset in this fact pattern. This Group member commented that the difference between the value in use of the ROU asset and the FVLCD would still be negligible because the difference in the two amounts is driven only by the two months associated with Entity X's use of the ROU asset. Therefore, the exception in paragraph 22(b) of IAS 36 would apply such that Entity X would perform the impairment test on the ROU asset separately from CGU 1.

Some Group members highlighted other points to consider. For example, since Entity X can sublease the ROU asset, an assessment may be required to determine if the change in use would result in classifying the asset as an investment property under IAS 40 *Investment Property* or whether it is a finance sublease. Furthermore, if a pending finance sublease would lead to a derecognition of the ROU asset, the entity should consider whether the asset meets the criteria to be

classified as held for sale under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Fact Pattern for Issue 3

- Same fact pattern as Issue 2, but the lease for the ROU asset contains certain restrictions and limitations on the ability to sublease the space to a third party.

Issue 3: How should the restrictions and limitations in Fact Pattern 3 be reflected in the impairment testing of the ROU asset?

Analysis

- As these restrictions and limitations are part of the lease for the ROU asset, they should be factored into determining the FVLCD in accordance with IFRS 13 *Fair Value Measurement*.
- Paragraph 27 of IFRS 13 requires that the fair value for a non-financial asset take into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.
- Paragraph 28 of IFRS 13 provides further guidance on determining highest and best use:

"The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (e.g. the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use."

The Group's Discussion

Group members supported the above analysis with regards to reflecting restrictions and limitations in the impairment test of the ROU asset. A Group member observed that in practice, entities may be in the process of renegotiating lease restrictions with their landlords, and this process takes time. This Group member raised a question whether an entity should consider the likelihood that some restrictions may be removed in determining the FVLCD of the ROU asset. One Group member thought that an entity would first determine the FVLCD based on the contractual terms of the lease contract. Then, the entity would assess from a market participant's view whether the restrictions may be removed and whether that would impact on how a market participant would assess fair value before such removal.

Issue 4: In the fact pattern described in Issue 1, it is assumed that the decision to vacate has been finalized and that the period of use by Entity X before the property is vacated is very short. In alternative scenarios, these factors may not be as clear. What are some factors to consider in assessing whether the ROU asset should be tested for impairment separately or as part of CGU 1?

Analysis

- Some factors to consider when determining whether the ROU asset should be tested for impairment separately from CGU 1 include, but would not be limited to whether:
  (a) plans for ceasing use of the ROU asset have been finalized and the entity is committed to vacating the property (for example, it has announced its decision to the affected parties) versus expecting to vacate, but not yet committed to vacate the property. When making this assessment, an entity might consider the guidance in paragraph 72 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on assessing when a constructive obligation to restructure arises.
  (b) the period of use by CGU 1 is a more extended period of use versus a relatively short period of use for the ROU asset;
  (c) the ROU asset is significant to the cash inflow generation of CGU 1;
  (d) the ROU asset can be subleased after it is vacated and the period of sublease relative to the period of use by Entity X before the property is vacated;
  (e) the space is expected to be subleased, considering the level of management and board support and the likelihood of being able to sublease the space (e.g. a signed sublease versus general expectations of market interest in the property).

The Group's Discussion

Group members generally supported the factors identified above in assessing whether the ROU asset should be tested for impairment separately or as part of CGU 1. Other factors to consider when assessing the level at which to test the ROU asset for impairment include whether the entity has engaged real estate brokers to market the ROU asset for sublease, communicated to the landlord its the decision to cease own use and to sublease, and told employees about ceasing the use of the office space. Such activities and communications help to establish that the decision to cease own use is substantive. Group members noted that it is important that an entity takes into consideration all relevant facts and circumstances and assesses holistically whether the ROU asset should be tested for impairment separately.

Overall, the Group's discussion about Issues 1 to 4 raises awareness about impairment testing considerations for an ROU asset in light of the current economic environment. No further action was recommended to the AcSB.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

Amended IAS 1: Application of Paragraph 72A to Classify a Term Loan as Current or Non-current

At the September 2020 meeting, the Group recommended the AcSB consider raising the issue of applying paragraph 72A to classify a term loan as current or non-current with the International Accounting Standards Board (IASB).

The AcSB discussed this issue at its December 16, 2020 meeting and noted that the IFRS Interpretations Committee (the Interpretations Committee) discussed this issue at its December meeting. The Board has decided that it will formally respond to the IFRIC tentative agenda decision.

OTHER MATTERS

Goodwill and Impairment

In March 2020, the IASB published the Discussion Paper, "Business Combinations—Disclosures, Goodwill and Impairment." The comments were 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.

Sustainability Reporting

The IFRS Foundation Trustees published a Consultation Paper on Sustainability Reporting to determine whether there is a need for global sustainability standards, whether the IFRS Foundation should play a role, and what the scope of the role should be. The comments were due December 31, 2020.

Configuration or Customization Costs in a Cloud Computing Arrangement

In December 2020, the Interpretations Committee published a tentative agenda decision on the customer's accounting for costs of configuring or customizing the supplier's application software in a Software as a Service arrangement. In analyzing the fact pattern, the Interpretations Committee considered:

1. whether, applying IAS 38, the customer recognizes an intangible asset in relation to configuration or customization of the application software; and
2. if an intangible asset is not recognised, how the customer accounts for the configuration or customisation costs

The Interpretations Committee members agreed with the analysis in the IFRIC agenda paper on the accounting for costs of configuring and customizing the suppliers' application software to which it receives access and the reference to IFRS 15 to determine when the supplier performs the configuration or customization services in accordance with the contract to deliver them. Stakeholders are encouraged to submit their comments on this tentative agenda decision by February 15, 2021.

Classification of Debt with Covenants as Current or Non-current

In December 2020, the Interpretations Committee published a tentative agenda decision on the application of the amendments to IAS 1 to determine whether an entity has a right to defer settlement of the liability for at least 12 months after the end of the reporting period. The Committee discussed how an entity applies the IAS 1 amendments to particular fact patterns. In all three fact patterns

described in this tentative agenda decision, the Committee concluded that the entity is required to classify the loan as current because the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least 12 months after the reporting period. Stakeholders are encouraged to submit their comments on this tentative agenda decision by February 15, 2021.

Lease Liability in a Sale and Leaseback

The IASB proposes 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 published the Exposure Draft in November 2020. Stakeholders are encouraged to submit their comments on this document by March 29, 2021.

Post- implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interest in Other Entities*

The IASB published the Request for Information, "Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*". Post-implementation reviews are part of the IASB's due process and help the IASB assess the effects of requirements on users of financial statements, preparers and auditors. Stakeholders are encouraged to submit their comments on this document by May 10, 2021.

Business Combinations under Common Control

The IASB published the Discussion Paper, "Business Combinations under Common Control". This Discussion Paper includes proposals that aim to reduce the diversity in practice and improve the transparency and comparability of the reporting on such combinations. Stakeholders are encouraged to submit their comments on this document by September 1, 2021.

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 Board in undertaking various activities to ensure Canadian perspectives are considered internationally. Since these discussions do not relate to assisting stakeholders in applying issued IFRS Standards, this portion of the Group's meeting is generally conducted in private (consistent with the Board's other advisory committees).

IASB – Documents for Comments

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

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

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

- IASB Exposure Draft, "Lease Liability in a Sale and Leaseback"