IFRS® Discussion Group

Report on the Public Meeting

June 20, 2019

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. 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 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 JUNE MEETING

Timing of Applying Agenda Decisions

In December 2018, the International Accounting Standards Board (IASB) confirmed its view that companies are entitled to sufficient time to implement changes in an accounting policy that result from an IFRS Interpretations Committee (IFRIC) agenda decision.

The Group considered the meaning of "sufficient time" in applying a published IFRIC agenda decision.

Issue 1: What does "sufficient time" mean? And what factors should be considered?

In her article "Agenda decisions–time is of the essence," Sue Lloyd, Vice-Chair of the IASB and Chair of the IFRS Interpretations Committee, shared the following broad considerations to interpret sufficient time:

(a) It depends on facts and circumstances.

(b) It depends on the accounting policy change and the reporting entity.

(c) Preparers, auditors and regulators will need to apply judgment.

(d) The rule of thumb is months, not years.

(e) Should be on a timely basis; in other words, as soon and as quickly as possible.

(f) Extensive periods of time not required, given agenda decisions typically consider specific transactions or narrow fact patterns, reflect existing requirements and do not require standard setting.

(g) Companies need to be diligent and make a good faith effort to consider and address any effects on a timely basis.

(h) The goal is high-quality, consistent application of IFRS Standards.

The Group's Discussion

The Group appreciated the guidance the IASB provided to clarify the meaning of sufficient time to apply an IFRIC agenda decision. Specifically, the Group found the rule of thumb being months, not years to be useful. Many Group members also agreed that preparers should assess the facts and circumstances of the situation and make a good faith effort to interpret what is meant by sufficient time to implement an IFRIC agenda decision. Some Group members noted communication between financial statement preparers, their auditors, and the securities regulators is important to ensure the interpretation of sufficient time is aligned.

The Group discussed factors to consider whether an entity has sufficient time to implement an agenda decision close to the end of a reporting period. Some Group members observed that the IFRS Interpretations Committee (Committee) provides regular updates on its discussion which often convey preliminary views from Committee members on issues discussed in advance to issuing the finalized agenda decision. It is reasonable to expect that entities should assess the impact of the tentative agenda decision before it is finalized. However, it was also observed that an entity might consider the possibility that a tentative agenda decision may not be finalized as proposed before investing in system changes. In addition, depending on the complexity of the agenda decision, an entity may be able to implement the agenda decision relatively quickly.

Some members noted that the application of sufficient timing is entity specific. The narrow fact patterns noted in item (f) may imply the agenda decision may apply to few entities. However, to the entities that are impacted by the decision, the time and effort to implement the final agenda decision could be substantial.

The Group then commented on paragraphs 8.4 and 8.5 in the Due Process Handbook Review Exposure Draft published by the IASB regarding agenda decisions. Several Group members noted that public companies often consider the agenda decisions to be authoritative in-substance. Therefore, they questioned whether the Due Process Handbook is the appropriate section to emphasize the importance and the urgency of implementing the agenda decisions. Some Group members requested that the IASB provide additional clarification on the phrase "new information" in paragraph 8.5 of the Exposure Draft. One Group member commented that the phrase "new information" appears in the first and the last sentence of the paragraph but carries different meanings. In the first sentence, "new information" appears to refer to the IFRIC agenda decision necessitating an accounting policy change. "New information" in the last sentence appears to refer to the mechanics of adopting the change. Another Group member noted that "new information" could be interpreted as a change in accounting estimate, rather than a change in accounting policy. The IASB should clarify wording to resolve this inconsistency. The AcSB will consider these comments when drafting its response letter to the IASB.

Issue 2: Does sufficient time include the time needed to undertake related steps, such as changing affected covenants in documents?

The IASB has formally acknowledged that it takes time to implement an accounting policy change including time for an entity to obtain new information or adapt its systems to implement the change. Ms. Lloyd's article indicated that the time needed to undertake related steps, such as debt covenant modifications, go beyond what was contemplated for as sufficient time.

The Group's Discussion

The Group agreed with the views expressed in Ms. Lloyd's article. All but one Group member thought that the time an entity spends on activities such as debt covenant modification is a separate process from the implementation of an accounting policy change. One Group member commented that depending on the impact of the change in accounting policy on the entity's compliance with debt covenants and where the agenda decision is finalized close to a period end where compliance with debt covenants is measured, a case could be made for extra time to implement the agenda decision to allow some reasonable length of time for renegotiation of covenants.

Issue 3: Should companies be allowed to wait to see whether any of the Board's projects could remove the need to make an accounting policy change (i.e., to avoid two changes in accounting in a short period of time)?

Ms. Lloyd's article also indicated the "wait-to-see" approach to avoid two changes in accounting in a short period of time described in Issue 3 goes beyond what was contemplated as sufficient time.

The Group's Discussion

The Group agreed with the views expressed in Ms. Lloyd's article that an entity should not wait to see the outcome of future IASB projects to avoid implementing the current agenda decision.

Issue 4: If an entity has not yet reflected in its financial statements an accounting policy change as a result of an IFRIC agenda decision, should management consider providing IAS 8.30 disclosures for new IFRS Standards issued but not yet effective by analogy?

Although paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* focuses on new IFRS Standards that are issued but not yet effective, it seems to be relevant, by analogy, to IFRIC agenda decisions. The disclosure of this information will typically provide relevant information to users to understand forthcoming changes to financial statements. Canadian Securities Administrators (CSA) staff indicated that National Instrument 51-102 *Continuous Disclosure Obligations* requires an entity to discuss and analyze any changes in its accounting policies, such as those related to the application of IFRIC agenda decisions, in their Management Discussion and Analysis. Furthermore, they commented that disclosure would be most relevant where the change could be significant, but management has not yet implemented the change due to complexity.

The Group's Discussion

The Group agreed with the analysis, noting that paragraph 30 of IAS 8 is relevant by analogy to IFRIC agenda decisions. Some Group members commented that these disclosures will provide greater transparency to financial statement users on forthcoming changes to financial statements. Furthermore, Group members thought that these disclosures will also improve comparability between companies implementing the same agenda decisions at different times.

Overall, the Group's discussion raises awareness about interpreting the meaning of sufficient time in applying IFRIC agenda decisions. No further action was recommended to the AcSB.

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

IFRS 16: Determining Lease Payments

The Group considered the accounting under IFRS 16 *Leases* by a lessee and lessor for a leasing arrangement that contains a co-tenancy clause.

Fact Pattern

- Retailer A is a retail company that has entered into a lease agreement with Company B for the use of a specified commercial rental unit (CRU) within a shopping centre for five years (non-cancellable period) with annual rental payments of $50,000 in Years 1 through 3 and $60,000 in Years 4 and 5 due at the end of each year (hereafter referred to as the "base rent"). Assume that the arrangement contains a lease as defined in IFRS 16.
- The lease contains a co-tenancy clause stipulating that if a specified anchor tenant vacates its space in the shopping centre, Retailer A's rental payments would be revised to "percent rent" based on 5 percent of Retailer A's gross annual sales from the leased location at the shopping centre. The lease also stipulates that once the anchor tenant space is re-occupied, Retailer A's rental payments would revert to the base rent.
- At the lease commencement date, Retailer A determines the lease term to be five years.
- At the beginning of Year 2, the specified anchor tenant vacates its space in the shopping centre, triggering the co-tenancy clause. As a result, Retailer A's rental payments are revised to percent rent. During Year 2, Retailer A's gross annual sales from the CRU leased location are $600,000; therefore, Retailer A's rental payments for Year 2 are $30,000 (i.e., $600,000 × 5%).

Issue 1: At the lease commencement date, how should Retailer A determine its lease payments as per IFRS 16 in measuring its lease liability? Subsequently, how should Retailer A account for the change in annual rental payments at the beginning of Year 2, when the anchor tenant vacates the shopping centre?

View 1A – At lease commencement date, the base rent should be treated as fixed lease payments. Upon the anchor tenant vacating the shopping centre, there should be no remeasurement of the lease liability.

Proponents of this view note that the measurement of a lease liability is based on the lease payments as of the lease commencement date. On the lease commencement date, the co-tenancy clause was not triggered. The certain anchor tenant was occupying the space in the shopping centre, and the base rent is the fixed lease payments for the lease term of five years. Since the co-tenancy clause is designed to be protective for the lessee and would not affect the payment terms until the triggering event occurs, any amount associated with the variability that results from this clause should be excluded from the lease payments and the initial measurement of the lease liability.

Subsequently, at the beginning of Year 2 when the co-tenancy clause is triggered, Retailer A would not remeasure its lease liability and right-of-use (ROU) asset. This is because the triggering of the co-tenancy clause does not meet the reassessment requirements for the lease liability outlined in paragraphs 39-43 of IFRS 16. In addition, the lease payments do not qualify as in-substance fixed

lease payments described in paragraph B42(a)(ii) of IFRS 16 because triggering the co-tenancy clause does not resolve a contingency for the remainder of the lease term.

As a result, the difference between the actual lease payment ($30,000) and the fixed payment that would apply had the co-tenancy clause not been triggered ($50,000) should be treated as a negative variable lease payment in accordance with paragraph 38(b) of IFRS 16.

View 1B – At lease commencement date, the same treatment applies as View 1A. However, on the anchor tenant vacating the shopping centre, the lease liability should be remeasured.

At the beginning of Year 2, when the co-tenancy clause is triggered, Retailer A would remeasure its lease liability and ROU asset. Proponents of this view apply paragraph B42(a)(ii) of IFRS 16 by analogy and consider the triggering of the co-tenancy clause to represent a resolution of the variability for some or all the lease payments for the remainder of the lease term. Therefore, the lease payments are in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that in substance, are unavoidable. The revised in-substance fixed lease payments should be reflected in the lease liability in accordance with paragraph 36(c) of IFRS 16. Under this approach, Retailer A will reassess the lease liability whenever the co-tenancy clause is triggered and then subsequently revert to the base rent if the co-tenancy clause ceases to be in effect.

View 1C – At lease commencement date, there are only variable lease payments not dependent on an index or a rate within this leasing arrangement.

Under this view, since the lease payments are subject to adjustment based on the co-tenancy clause, the lease payments are viewed as variable lease payments not dependent on an index or a rate. Accordingly, the lease liability is initially measured at zero, and lease expense is recognized prospectively based on the amount actually incurred each year in accordance with paragraph 38(b) of IFRS 16.

View 1D – At lease commencement date, apply the in-substance fixed lease payment provisions of paragraphs B42(b) and (c) of IFRS 16.

Proponents of this view consider the co-tenancy clause to represent multiple sets of payments Retailer A could make. To qualify as in-substance fixed lease payments as described in paragraphs B42(b) and (c) of IFRS 16, Retailer A must decide whether one or more of these sets of payments are realistic.

If only one set of payments is realistic, paragraph B42(b) of IFRS 16 requires an entity to consider only the realistic set of payments to be the lease payments. For example, if it is not realistic that the anchor tenant would vacate its space for any period during the term of the lease, Retailer A's in-substance fixed lease payments are the base rent.

Paragraph B42(c) of IFRS 16 applies when more than one set of payments is realistic, but the entity must make at least one of those sets of payments. In such case, the entity is required to consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments. For example, if the anchor tenant vacating the shopping centre is one of the realistic sets of

payment, then the Retailer A's in-substance fixed payments are zero. Consequently, the lease liability is initially measured at zero.

The Group's Discussion

Most Group members thought View 1A to be the technically correct answer to account for the lease with a co-tenancy clause under IFRS 16. They noted that this view reflects the obligation for the lease at the lease commencement date. One Group member viewed the co-tenancy clause as being protective for the tenant and that any subsequent departure by the anchor tenant does not result in variable rent payments. Several Group members also considered View 1B to be acceptable when the prospect of having a new anchor tenant is so remote that the lease payments are unlikely to revert to the base rent during the lease term. One Group member noted that the threshold to remeasure under item B42(a)(ii) of IFRS 16 is quite high as the relevant contingency must be resolved for the "remainder of the lease term." As a result, the circumstances supporting View 1B are limited.

Some Group members supported View 1B, noting remeasurement after the anchor tenant leaves reflects the economic reality of the retail industry being disrupted by e-commerce. Furthermore, these Group members thought that when there is limited prospect of getting a replacement anchor tenant, remeasurement of the lease liability will reflect the cash flows to be paid by the tenant. One Group member also noted that View 1A could result in an impairment of the right-of-use asset after the anchor tenant leaves and recognition of gain when the percent rent is less than the fixed rent that was paid when the anchor tenant was still present. It can be argued that this causes an accounting mismatch and does not reflect the economic substance of the transaction. However, another Group member commented that when the anchor tenant leaves, the economic reality is that the lease becomes less valuable. This economic reality is reflected in the impaired ROU asset and the future gain if rent is lower in future periods.

The Group noted that the specific terms of the contract could impact the accounting treatment. Some Group members noted that some contracts allow the tenant to terminate the contract or renegotiate the contract if the anchor tenant leaves. Group members also thought that contract terms should be reviewed carefully to determine the appropriate accounting treatment.

Several Group members expressed concerns over View 1C and 1D, noting that in practice, these tenant payments are not viewed as variable payments.

Issue 2: How should Company B (the lessor in this leasing arrangement) account for the co-tenancy clause?

Analysis

Since the definition of "lease payments" as per Appendix A of IFRS 16 is the same for the lessee and lessor, it seems appropriate that how Company B would determine lease payments should be the same as the views for the lessee's accounting under Issue 1.

The Group's Discussion

For this discussion, the lessor is accounting for the lease as an operating lease.

Most Group members agreed with the analysis and that the definition of lease payments is the same

for the lessee and lessor. One Group member observed that IFRS 9 impacts the accounting for recognized lease payments for finance leases and any accrual for operating lease payments. One Group member expressed concern over the lessor recognizing revenue on a straight-line basis when the prospect of getting a replacement anchor tenant is remote. Recognizing lease revenue on a straight-line basis would assume the anchor tenant will be replaced, which does not reflect the economic reality of the transaction.

Overall, the Group's discussion raises awareness about the practical application of IFRS 16 on a leasing arrangement that contains a co-tenancy clause. No further action was recommended to the AcSB.

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

IFRS 16: Right to Control Assessment

Under IFRS 16 *Leases*, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraph B9 of IFRS 16 further requires two criteria to be met to demonstrate the right to control the use of an identified asset:

1. the right to obtain substantially all of the economic benefits from use of the identified asset; and
2. the right to direct the use of the identified asset.

In the oil and gas industry, companies commonly structure arrangements where a customer has a right to both a fixed committed volume of the capacity of an identified asset (e.g., processing facility or pipeline) and a right of first refusal/offer (ROFR) over the remaining capacity.

The Group discussed whether the fact that a customer has a right to obtain additional capacity through a ROFR gives that customer the right to substantially all of the economic benefits of the asset.

Fact Pattern

Company A enters into a 10-year contract with Company B for 70 percent of the capacity of a specific gas pipeline. Company A also has a right of first refusal over the remaining 30 percent of the capacity of the pipeline, such that Company B can only sell additional capacity to other customers if Company A agrees not to purchase the remaining capacity. The pricing of the contract is at market terms. Assume there are other potential customers in the vicinity that could use the additional capacity.

Issue: Does the fact that Company A has a right to obtain the additional available capacity through a ROFR give it the right to substantially all the economic benefits of the asset? Or should the assessment be based on the likelihood that Company A will use the additional capacity?

View A – The legal right to take the additional capacity before it is offered to others gives the customer the right to substantially all of the capacity of the pipeline

Proponents of this view consider that the ROFR gives Company A the right to obtain substantially all

of the economic benefits from the use of the pipeline by restricting others from purchasing the additional capacity. Although the exercise of the ROFR is conditional on Company B finding a third party to take the excess capacity, the ROFR prevents Company B selling the additional capacity to any third party without Company A's permission. Therefore, the ROFR gives the customer (Company A) the right to substantially all of the capacity of the underlying asset.

Given the ROFR has been priced into the arrangement, the assessment of whether the right is substantive is limited to situations where it is clearly non-substantive, such as when the exercise price is well above market.

View B – Evaluate the ROFR based on facts and circumstances considering whether Company A intends to use the additional capacity

Proponents of this view support using a similar assessment from the superseded IFRIC 4 *Determining whether an Arrangement Contains a Lease* to determine whether the ROFR represents the right to control the underlying asset. Using IFRIC 4, Company A should consider facts and circumstances, such as its intention to use substantially all of the pipeline's capacity, to determine whether it has a right to substantially all of the economic benefits of the identified asset.

In considering whether the ROFR is a substantive right, Company A may consider the guidance in paragraph B22 of IFRS 10 *Consolidated Financial Statements* and assess whether it has the practical ability to exercise the right. Therefore, although the ROFR was negotiated as part of the arrangement and would have been priced into the contract, it could be considered non-substantive if it is unlikely that the ROFR will be exercised.

The Group's Discussion

Group members expressed diverse views on this issue.

One Group member observed that in the oil and gas industry, many factors beyond pricing, can make the ROFR non-substantive and unlikely to be exercised. Some examples of these factors include:

(a) The production forecast does not economically justify purchasing additional capacity.
(b) The ability to share the operating costs with new customers creates an economic incentive to not exercise the ROFR.
(c) The ROFR is included as a price protection for the lessee to prevent a lower price being offered to a new customer.
(d) Existence of the right for the asset owner to expand the capacity to include a second customer once the ROFR is exercised.

This Group member further noted that paragraph B37 of IFRS 16 requires an entity to consider all relevant facts and circumstances when determining whether the lease term extension or purchase option will be exercised. The same guidance could be used to determine whether the option to obtain additional capacity is substantive. Therefore, a lease containing a ROFR should be evaluated based on all relevant facts and circumstances, including the intention to use the additional capacity. This Group member prefers View B.

Several Group members supported View A, because based on the fact pattern as presented, the

ROFR gives Company A the right to substantially all of the economic benefit from use of the pipeline throughout the period of use. However, these Group members acknowledged that in the oil and gas industry, the terms and conditions of arrangements with a ROFR clause are complex and can differ widely. To illustrate the complexity, some Group members shared their experience on different ways they observed a ROFR being structured in various arrangements. Furthermore, these members thought that factors beyond pricing could impact the determination of whether the ROFR is substantive. Group members stressed the importance of careful consideration of all the specific facts and circumstances when determining the appropriate accounting for these arrangements.

Some Group members discussed whether Company A's intention to exercise its rights should be factored in deciding whether the ROFR is substantive. These Group members thought that an entity's determination of whether a right is substantive should consider the guidance in paragraph B22 of IFRS 10 and whether the lessee has the practical ability to exercise that right. Hence, they thought the practical ability to be an important factor in the substantive right assessment.

The Group briefly discussed the unit of account for this arrangement. One Group member noted that in order to be in scope of IFRS 16, the asset must be an identified asset. A capacity portion of an asset is not an identified asset unless it represents substantially all of the capacity of that asset. Therefore, it is important to assess whether the capacity portion of the pipeline represents substantially all of the pipeline capacity. One other Group member also observed that in the oil and gas industry a pipeline is generally the unit of account for this arrangement.

Overall, given the diversity of views and the potential impact on the oil and gas industry, the Group recommended this issue be discussed by the AcSB. The AcSB will discuss this issue at its July 2019 meeting to determine what further action can be taken to clarify the guidance.

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

IFRS 15 and IAS 10: Realization of Variable Consideration

IFRS 15 *Revenue from Contracts with Customers* requires an entity to estimate variable consideration when determining the transaction price. The estimated variable consideration should only be included in the transaction price to the extent that it is highly probable that there will not be a subsequent significant reversal. Furthermore, at the end of each reporting period, the entity should update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

New information related to variable consideration may arise between the end of the reporting period and the date when the financial statements are authorized for issue. The Group is asked to consider whether this information is considered to provide evidence of conditions that existed at the end of the reporting period (i.e., an adjusting event). Paragraph 8 of IAS 10 *Events after the Reporting Period* requires the entity to recognize the amounts in its financial statements reflecting the adjusting events after the reporting period.

Fact Pattern

- Entity A enters into a contract with Customer Z on November 30, 2018, to deliver 100 widgets on

December 31, 2018 (which is when the performance obligation is satisfied). The transaction price is $1,000 per widget and there are no other performance obligations in the contract. Entity A has a 30-day return policy. Payment is due on January 31, 2019.

- Entity A has a December year-end and financial statements will be authorized for issue March 31, 2019.
- Historical returns have been 3-5 percent of total widget sales for each respective month.
- In considering the requirements for constraining the estimate of variable consideration, based on historical returns and circumstances present at December 31, Entity A concluded that it is highly probable that a significant reversal in the revenue recognized for Customer Z will not occur if a transaction price of $95,000 is used, applying estimated returns of 5 percent.
- Customer Z returned two widgets (or 2 percent) on January 30, 2019.

Issue: Is the return of two widgets subsequent to the reporting date an adjusting event under IAS 10?

View A – Yes, the return of two widgets subsequent to the reporting date is an adjusting event under IAS 10

Proponents of this view note when the uncertainty associated with the variable consideration was resolved in the subsequent event period, it provided evidence of conditions that existed at the end of the reporting period. Therefore, Entity A should adjust the estimate of variable consideration recognized in its financial statements.

View B – No, the return of two widgets subsequent to the reporting date is not an adjusting event under IAS 10

Proponents of this view note that the variability was resolved as a result of conditions that arose after the reporting period and did not represent circumstances present at the reporting date. Entity A should not adjust the estimate of variable consideration recognized in its financial statements.

In this scenario, Entity A would not adjust the estimate of variable consideration recognized in its financial statements. The financial statements should reflect the uncertainty related to the variable consideration that existed on December 31.

The Group's Discussion

Most Group members supported View B. These members considered the management's process to estimate variable consideration to be rigorous. Absent any abnormal circumstances of the return that can raise questions about the accuracy of the management's estimate, the year-end estimation does not need to be adjusted. One Group member commented the development in data analytics can improve forecast accuracy and reduce likelihood of differences between estimates and actual results occurring in the future.

Some Group members supported View A. One Group member noted that if the uncertainties associated with the variable consideration were resolved subsequent to the reporting date, then revenue should be adjusted to reflect the certainty. A few Group members discussed examples in IAS 10, IAS 2 *Inventories*, and IFRS 9 *Financial Instruments* and considered the judgement involved

in determining whether subsequent changes in value will need to be reflected in estimates at the year-end. For example, one Group member thought of analogizing to the example in paragraph 9(a) of IAS 10 in considering whether to adjust the estimate based on the updated information.

Other Group members focused on the nature of the intervening events that caused the difference between actual and estimated returns. If the intervening event does not relate to circumstances that existed at the reporting date, then the variable consideration should not be adjusted. Otherwise, the estimate may need to be adjusted.

Overall, the Group's discussion raises awareness about the considerations to determine whether information subsequent to the reporting date should result in an adjustment to estimated variable consideration. 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: Statute Barred Payables

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).

IFRS 9: Fair Value Option

IFRS 9 *Financial Instruments* defines a financial liability at fair value through profit or loss (FVTPL) as a financial liability that meets the definition of held for trading or is designated by the entity in accordance with certain criteria in IFRS 9. This option to designate at FVTPL is referred to as the "fair value option."

The Group considered a fact pattern in the context of an investment entity to discuss factors to consider in applying the fair value option, and the related measurement and presentation implications once that option is taken.

Fact Pattern

- Investment Entity A meets the definition of an investment entity and measures its investments on a fair value basis in accordance with IFRS 10 *Consolidated Financial Statements*. The entity reports fair value information to its key management personnel to evaluate the performance of substantially all of its investments and to make investment decisions. Investment Entity A has no equity.
- Investment Entity A issued a term loan for general borrowing purposes to finance the purchase of non-specific types of assets (e.g., real estate, private equities, and fixed income). The term loan is not managed as part of any portfolio for which there is evidence of a recent pattern of short-term profit-taking, nor is the term loan incurred with an intention to repurchase it in the near term due to changes in the loan's fair value. The term loan is repayable at maturity and

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

collateralized by Investment Entity A's assets.

- The entity has a triple-A credit rating. Therefore, the term loan is issued to maximize the returns given the difference between the cost of borrowing and the expected return on the purchased assets.

Issue 1A: Is the term loan described in the fact pattern considered held for trading?

Analysis

Paragraph BA.7 of IFRS 9 provides guidance for assessing whether financial liabilities are held for trading, indicating that such liabilities include:

(a) derivative liabilities that are not accounted for as hedging instruments;

(b) obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);

(c) financial liabilities that are incurred with an intention to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

(d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

Based on the fact pattern, the term loan does not fit the characteristics of an instrument that is held for trading as contemplated in paragraph BA.7 of IFRS 9. The reasons are that the entity has no intention to repurchase the term loan in the near term and does not manage the term loan as part of a portfolio for short-term profit-taking purposes. The term loan is held to maximize the return between the purchased assets and the low cost of debt. Paragraph BA.8 of IFRS 9 goes on to state that "the fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading."

The Group's Discussion

The Group agreed with the analysis above.

Issue 1B: Could the term loan be designated at FVTPL using the fair value option in IFRS 9?

Analysis

Paragraph 4.2.2 of IFRS 9 states:

> "An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:
>
> (a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29–B4.1.32); or

(b) a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures*), for example, the entity's board of directors and chief executive officer (see paragraphs B4.1.33–B4.1.36).”

Based on the fact pattern, Investment Entity A reports fair value information to its key management personnel to evaluate the performance of substantially all of its investments and to make investment decisions. Financial assets and financial liabilities are part of portfolios that have different risk profiles and are managed on a fair value basis. Since the term loan is part of a group of financial assets and liabilities that are managed on a fair value basis, the criterion in paragraph 4.2.2(b) of IFRS 9 is considered met such that the term is eligible for designation at FVTPL.

The Group’s Discussion

Group members agreed with the analysis above and highlighted that a portfolio manager manages on a fair value basis, including looking at the borrowings and investments in evaluating performance on a net basis. One Group member pointed out that it is important to establish a strong correlation between the investment and the term loan. For example, if the general borrowing was not used for a long period of time, or only a portion is used for investment purposes, then that could make it more challenging to support that the financial instruments are managed together.

Issue 2: Assume the term loan is designated at FVTPL. Does the recognition in other comprehensive income of the fair value change of the term loan that is attributable to changes in credit risk of that loan create or enlarge an accounting mismatch in profit or loss?

Analysis

Paragraphs 5.7.7 and 5.7.8 of IFRS 9 provide guidance on where the fair value change of the financial liability that is attributable to changes in credit risk of that financial liability is presented in the statement of comprehensive income.

Paragraph 5.7.7(a) of IFRS 9 would require the fair value change of the term loan that is attributable to changes in credit risk of that loan to be recognized in other comprehensive income, unless the treatment of the credit risk component creates or enlarges an accounting mismatch in profit or loss. If this is the case, paragraph 5.7.8 of IFRS 9 would require all the fair value change of the financial liability to go through profit or loss (i.e., not necessary to present the credit risk component in other comprehensive income).

Furthermore, paragraphs B5.7.5-B5.7.20 of IFRS 9 provide application guidance for liabilities designated at FVTPL. To determine whether treatment of the credit risk component creates or enlarges an accounting mismatch, an entity needs to assess whether it expects the term loan’s credit risk changes will be offset in profit or loss by another financial instrument’s fair value change measured at FVTPL. The expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument.

In this fact pattern, while the credit risk of the term loan may be related to the total value of Investment Entity A's financial assets, the credit risk is also influenced by other factors, such as:

(a) the term loan's priority relative to other liabilities;

(b) whether the term loan is collateralized;

(c) whether the financial assets are available to be used for other purposes; and

(d) other assets, liabilities, activities and expenditures of Investment Entity A.

In addition, the term loan is issued for general borrowing purposes. It would be difficult to establish a sufficiently direct economic relationship between the term loan and another financial asset. As a result, treatment of the credit risk component in other comprehensive income in this fact pattern does not create or enlarge an accounting mismatch because the term loan's credit risk is not necessarily offset by the fair value change of another financial instrument measured at FVTPL.

The Group's Discussion

Group members agreed with the analysis above. One Group member emphasized that paragraph B5.7.6 of IFRS 9 specifically indicates that the economic relationship between the characteristics of the liability and the characteristics of the other financial instrument must be considered in determining whether the other comprehensive income treatment described in paragraph 5.7.7(a) of IFRS 9 would create or enlarge an accounting mismatch in profit or loss. This means that an entity would need to identify a feature of the other financial instrument that moves in tandem with the effects on the financial liability's fair value change attributable to the credit risk of that liability to support that such economic relationship exists.

Issue 3: Assume that an accounting mismatch is not created or enlarged in profit or loss as a result of recognizing the credit risk change of the term loan in other comprehensive income. What are some presentation considerations for Investment Entity A's financial statements relating to the credit risk component given it has no equity?

For investment entities, the most relevant information for a shareholder or unitholder is the net asset value on a fair value basis, which is total financial assets less total financial liabilities.

Some points to consider may include the following:

- The presentation format shown in Illustrative Example 7 of IAS 32 *Financial Instruments: Presentation* relating to the statement of comprehensive income and statement of financial position for entities with no equity. In summary, the statement of comprehensive income shows a total line item of "changes in net assets attributable to unitholders" and the statement of financial position shows "net assets attributable to unitholders" that comprises total assets less current and non-current liabilities.

- The magnitude of the changes in fair value of the term loan due to the credit risk of the loan. Paragraph B5.7.13 of IFRS 9 provides guidance in this area, contemplating how collateralization of a financial liability would affect whether the liability's credit risk would be significant or not.

- Guidance in IAS 1 *Presentation of Financial Statements* around the minimum line items to be presented in financial statements.

The Group's Discussion

Group members noted that paragraph 5.7.7(a) of IFRS 9 requires that the amount of change in the financial liability's fair value that is attributable to the change in that liability's credit risk must be presented in other comprehensive income when no accounting mismatch is created or enlarged in profit or loss. Therefore, entities need to develop an approach that would comply with this requirement. That said, Group members agreed with the presentation considerations described above.

One Group member noted that Illustrative Example 7 of IAS 32 and the presentation requirements in IAS 1 should be considered in developing an approach to separate net assets attributable to unitholders into its respective parts. Such parts may include the amount related to accumulated other comprehensive income. That said, another Group member noted that there are some questions in practice on applying Illustrative Example 7 of IAS 32.[2]

A few Group members shared that in their experience, the amount related to the change in the credit risk component from period to period is often not material for investment entities. Therefore, it is not separately presented in the statement of comprehensive income based on materiality. One reason for this could be that the investment entity's credit risk is influenced by the quality of the invested assets. If the financial liability is collateralized, the credit risk may be close to zero as acknowledged by paragraph B5.7.13 of IFRS 9.

One Group member also noted this issue is similar to thinking about how to present the cumulative translation adjustment when an investment entity has a Canadian-dollar functional currency but presents its financial statements in a different currency.

Overall, the Group discussed these issues to raise awareness on the application of the fair value option in IFRS 9. 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, IAS 12 and IFRIC 23: Uncertain Tax Positions Acquired in a Business Combination

The Group has previously discussed the issue of uncertain tax positions acquired in a business combination at its April 2012 and September 2015 meetings. 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) or in accordance with IAS 12 *Income Taxes* by virtue of applying the exception in paragraphs 24 and 25 of IFRS 3.

In May 2017, the IASB issued IFRIC 23 *Uncertainty over Income Tax Treatments*, with the effective date of January 1, 2019. IFRIC 23 clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments.

[2] Refer to the AcSB's comment letter to the IASB's Discussion Paper, "Financial Instruments with Characteristics of Equity."

The Group discussed the recognition and measurement of uncertain tax positions present in an acquired business, both on transition to IFRIC 23 and on an ongoing basis.

Issue 1: Does IFRIC 23 apply to the measurement of deferred tax assets and liabilities that arise as part of a business combination when there is uncertainty over income tax treatments that affect such assets and liabilities?

Paragraph 24 of IFRS 3 provides an exemption to both the recognition and measurement principles of IFRS 3: "The acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with IAS 12 *Income Taxes*." As a result, the deferred tax assets and liabilities of an acquired business are to be measured in accordance with IAS 12, rather than at fair value.

Furthermore, paragraph BC24 in the Basis for Conclusions to IFRIC 23 states that IFRIC 23 applies to the deferred tax assets and liabilities of an acquired business when there is uncertainty over income tax treatments that affect deferred tax.

Therefore, as IFRIC 23 is an interpretation of IAS 12, the deferred tax assets and liabilities affected by uncertain tax positions should be measured based on the principles of IFRIC 23.

The Group's Discussion

Group members agreed with the analysis above.

Issue 2: After adopting IFRIC 23, how should current tax assets acquired and current tax liabilities assumed in a business combination be measured when there are uncertain tax positions?

Unlike the deferred tax assets or liabilities, the current tax balances of an acquired company are not explicitly addressed by the recognition and measurement exemption in Paragraph 24 of IFRS 3. Consequently, different views exist in practice on whether IFRIC 23 or IFRS 3 should be applied to current tax assets and liabilities assumed in a business combination.

IFRIC 23 and IFRS 3 set out different measurement principles that may have the following impact on the way a current tax asset or liability is measured:

- IFRIC 23 requires the current tax balance to be measured using either the most likely amount or a probability weighted expected value approach, depending on which method would be considered to best predict the resolution of the uncertainty. In calculating the current tax balance, the entity assumes the tax authority will and can examine amounts it has a right to examine (i.e., the detection risk is presumed to be 100 percent).
- Under IFRS 3, the current tax balances would be measured at fair value. The probability that the tax authority may not examine the tax position is factored into the estimation of fair value (in other words, detection risk may be considered to be less than 100 percent).

Two scenarios are used to illustrate the differences:

<u>Scenario 1: Tax treatment is probable of being accepted by the tax authority</u>

(a) Business combination closes on December 15. The acquired company plans to deduct $100 in arriving at its taxable income of nil for its tax year ended December 31. The $100 deduction

represents an uncertain tax treatment.

(b) The acquired company's tax rate is 30 percent.

(c) The detection risk is 50 percent. The probability of the tax authority accepting the tax treatment is 60 percent.

(d) The outcome of the examination by the tax authority is binary. The tax deduction will either be accepted in full or completely denied.

Under IFRIC 23, because it is probable that the tax authority will accept the tax treatment, the current tax liability related to the uncertain tax position is $0.

Under IFRS 3, the determination fair value of the current taxes payable may consider the detection risk and the probability that the deduction may be denied in the calculation as follows:

$100 × 40% (risk that the deduction will be denied) × 50% (detection risk) × 30% (tax rate) = $6.

<u>Scenario 2: Tax treatment is not probable of being accepted by the tax authority</u>

Scenario 2 is the same as Scenario 1, except the entity believes it is not probable that the $100 tax deduction will be accepted by the tax authority. The probability of rejection is estimated at 60 percent.

Under IFRIC 23, since the deduction is expected to be denied, the entity will record the most likely amount of $30 ($100 × 30%) as the current tax liability.

Under IFRS 3, the fair value of the current tax liability may be determined as follows:

$100 × 60% (risk that the deduction will be denied) × 50% (detection risk) × 30% (tax rate) = $9.

The Group discussed the following three views on measurement of current tax assets and liabilities acquired or assumed in a business combination that occurs after the adoption of IFRIC 23.

View 2A – At fair value (IFRS 3)

Proponents of this view note that IFRS 3 was not amended by IFRIC 23 and IFRS 3 does not contain any specific exemptions to account for current tax assets and current tax liabilities acquired or assumed in a business combination. Therefore, they believe that the general requirements of IFRS 3 apply to current tax balances acquired and assumed in a business combination.

Under this view, the current tax liability related to the uncertain tax position is measured at $6 in Scenario 1 and $9 in Scenario 2.

View 2B – In accordance with IAS 12/ IFRIC 23

Proponents of this view believe that the exemption in IFRS 3 applies to all tax balances generated as a result of IAS 12. As IFRIC 23 was issued as interpretive guidance to IAS 12, the IFRS 3 exemption can be extended to encompass IFRIC 23.

Under this view, the current tax liability related to the uncertain tax position is recorded at $0 in Scenario 1 and at $30 in Scenario 2.

View 2C – Accounting Policy Choice

Proponents of this view believe that the literature is unclear. Therefore, either View 2A or View 2B could be supported.

The Group's Discussion

While some Group members supported View 2A and 2B based on the analysis performed, most members supported View 2C. Supporters of View C believe that the accounting literature continues to be unclear. Therefore, similar to the Group discussions in 2012 and 2015, these Group members continue to believe that there is an accounting policy choice.

One Group member observed that detection risk may not be a major contributor to the measurement differences of uncertain tax positions between IFRS 3 and IFRIC 23. There are other factors that drive differences, such as the probability of an uncertain tax position being accepted or denied.

Some Group members observed that if an entity follows View 2A in Issue 2, the entity will apply two measurement bases to the current and deferred tax balances from business combinations, even though they arose from one unit of account.

Issue 3: If IFRS 3 is applied in Issue 2 (i.e., View 2A or 2C in Issue 2), how should the entity reflect any Day 2 adjustments when applying IFRIC 23?

A "Day 2 adjustment" arises when different recognition and measurement requirements are applied to the initial and subsequent measurement of an asset or liability. This difference in requirements can result from different standards being applied at initial recognition and subsequent measurement. As illustrated in Scenario 1 to Issue 2 above, a difference of $6 could arise from the entity applying IFRS 3 at initial measurement (current tax liability: $6) but applying IFRIC 23 subsequently (current tax liability: $0).

View 3A – Apply IFRS 3 guidance on acquired/ assumed contingent liabilities by analogy

Proponents of this view believe IFRS 3 should be applied when measuring tax uncertainties related to income tax assets acquired and income tax liabilities assumed. The post-acquisition accounting for a contingent liability recorded in a business combination can be used by analogy to measure the current tax liability at the first reporting date after the acquisition. In accordance to paragraph 56 of IFRS 3, the uncertain tax treatment is recognized at the higher of:

(a) the amount initially recognized ($6 in Scenario 1 as illustrated in Issue 2 above); and

(b) the amount that would have been recognized in accordance with IFRIC 23.

Therefore, the current tax liability related to the uncertain tax position would continue to be recorded at $6 unless the measured value under the principles of IFRIC 23 exceeds $6.

View 3B – Apply IFRIC 23

Proponents of this view note IFRIC 23 should be applied to all uncertainties over IAS 12 tax balances recognized. Accordingly, the uncertainty over tax treatments associated with income tax assets acquired and liabilities assumed are recognized and measured in accordance with IFRIC 23 post-acquisition, even if the current tax balances were initially recorded at fair value under the principles of

IFRS 3. The effect of the change in measurement basis is recognized in the period as a gain or a loss.

Applying the same facts presented in Scenario 1 in Issue 2 above, the entity will record a gain of $6 through the statement of income at the next reporting date (the difference between the IFRIC 23 amount of $0 and the IFRS 3 amount recorded at acquisition of $6).

View 3C – Accounting Policy Choice

Proponents of this view believe the standard is not clear. Therefore, an appropriate accounting policy should be developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and should be applied consistently to recognition and measurement of all such tax uncertainties.

The Group's Discussion

The Group supported View 3B. Some group members noted that IFRIC 23 is an interpretation of IAS 12, which provides more specific guidance related to all uncertainties over IAS 12 tax balances recognized. Therefore, Group members thought that an IFRIC 23 approach should be followed instead of IFRS 3 accounting for contingent liabilities. One Group member commented that the initial fair value using IFRS 3 may not be significantly different from IFRIC 23. Hence, the amount of Day 2 adjustment to be recorded through the statement of income may not be material.

Issue 4: Transition – Assuming that an entity followed the approach described under View 3A in Issue 3, how should the entity measure current tax assets and liabilities that were subject to uncertainties at the time of a business combination that occurred before the date of adoption of IFRIC 23?

View 4A – Apply IFRIC 23 to the measurement of the current tax asset or liability subject to the uncertain tax position at the date of transition to IFRIC 23 only if it is probable that the tax position will not be accepted by the tax authorities. Otherwise, leave the previously recorded amounts unchanged until the uncertainties expire.

Proponents of this view believe the intention of paragraph BC23 of the Basis for Conclusions to IFRIC 23 is to make clear that IFRS 3 applies to prior treatment of tax uncertainties where a reasonable analogy to IFRS 3 for similar assets and liabilities was taken.

Under this view, in Scenario 1 presented above in Issue 2, the entity will continue to record the current tax liability of $6 on transition to IFRIC 23, assuming the probability of the tax position being overturned had not changed. In Scenario 2, assuming that the current tax liability was recorded in the purchase price allocation at its estimated fair value of $9 and remained unchanged at the date of adoption of IFRIC 23, the entity would adjust the current tax liability associated with the uncertain tax position to $30 since it is considered probable that the uncertain tax deduction would be denied by tax authorities.

View 4B – Apply IFRIC 23 to all uncertain tax positions outstanding at the date of initial application (including uncertainties acquired in past business combinations)

Proponents of this view argue that, post-acquisition, IAS 12 and all related interpretations are the relevant standards for the recognition and measurement of all income tax asset and income tax

liability balances within the scope of IAS 12. Further, IFRIC 23 applies to uncertainties of all such balances from the date of initial application, regardless of how those balances and uncertainties arose or were acquired. Therefore, the transition requirements of IFRIC 23 must be retrospectively applied without the use of hindsight under the full retrospective method, or under the cumulative catch-up method with adjustment to opening retained earnings.

Under this view, in Scenarios 1 and 2 presented above in Issue 2, the current tax liabilities associated with the uncertain tax positions would be adjusted to their respective IFRIC 23 balances of $0 for Scenario 1 and $30 for Scenario 2.

Questions can also arise as to whether the effect of this adjustment should be recorded in opening retained earnings on adoption of IFRIC 23 or as an adjustment to the goodwill that arose in the prior business combination. Generally, such an adjustment would most appropriately be recorded in opening retained earnings since adjusting the amounts recorded in the business combination would seem to require the use of hindsight, which is explicitly prohibited in the transition guidance to IFRIC 23.

View 4C – Accounting policy choice

Proponents of this view would argue that the standards are not clear and, therefore, there is an accounting policy choice.

The Group's Discussion

The Group supported View 4B, noting that a consistent application of IFRIC 23 should be followed, regardless of how those balances arose or were acquired.

One Group member noted the practical challenges of applying View 4A being the entity would be required to track all uncertain tax positions existing at the IFRIC 23 adoption date in order to distinguish any balances that arose from past business combinations; and that the entity may not have access to the required information.

Overall, the Group considered this issue to be prevalent in practice given the recent adoption of IFRIC 23 and recommended this issue be discussed with the AcSB. Specifically, the Group questioned whether the exception described in paragraph 24 of IFRS 3 could be revised to include both the current and deferred tax asset or liability. The AcSB will discuss this issue at its July 2019 meeting and consider whether to raise this issue with the IASB.

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

Client Money

The term "client money" is used to describe a variety of arrangements in which an entity holds funds on behalf of its clients. Such arrangements may include:

- a bank may hold money on deposit in a customer's bank account;
- a fund manager or stockbroker may hold money as a trustee on a customer's behalf;
- an insurance broker may hold premiums paid by policyholders before passing them on to an insurer; or

- a lawyer or accountant may hold money on a client's behalf, often in a separate client bank account where the interest earned is for the client's benefit.

The variety in contractual terms, conditions and the economic substance of these arrangements can make the recognition of financial asset analysis complex for the entity. To properly conclude the client money is a financial asset, the entity assesses whether the "control" and "benefits" aspects of the definition of an asset have been met. The relevant legal, regulatory and contractual requirements must be reviewed to make this assessment.

Two examples are used to illustrate a more straightforward analysis of "control" and "benefit":

Example 1: A bank that holds money on deposit in a customer's bank account should record a financial asset (cash) on initial receipt and a financial liability (customer deposits).

The bank has control of the cash and can use it to fund its investing and lending activities or to meet operating costs. It also has a financial liability to the customer who can draw on the funds and receives interest income.

Example 2: Under current practice, a lawyer that holds client money in a separate bank account would not recognize an asset where the funds may only be disbursed pursuant to the client's instructions and the lawyer is not entitled to any interest income.

Neither the "control" nor "benefits" aspects of the definition of an asset have been met because:

- the funds are held in a separate bank account and their use by the lawyer is restricted; and
- the lawyer does not appear to have the rewards of ownership of the funds in that it does not receive the benefit of the interest income.

In other cases, the substance of the contractual arrangements may not be as clear, and a more detailed analysis will be required. The Group is asked to consider the accounting for client money in these not- straightforward situations.

Issue 1: What matters should be considered when applying the concepts of 'control' and 'benefit' to client money arrangements?

In applying the concepts of "control" and "benefits" to client money arrangements, an entity should consider:

(a) the evaluation of control should take account of the extent to which the reporting entity is able to determine the use of the monies; and

(b) the evaluation of the benefits should take account of which party obtains the risks and rewards associated with ownership.

The following matters should be considered when applying the asset recognition criteria to client money arrangements:

(a) The extent (if any) that the entity has the right to use the funds.

(b) Consider whether the entity has the right to control the investment policy in relation to the funds and the ability to commingle the funds.

(c) Whether the entity obtains the benefit of interest income earned from the funds.

(d) Whether the entity retains all the interest or pays a lower rate of interest to clients and receives an economic benefit from the client money.

(e) Whether the entity bears the credit risk associated with bank accounts in which funds are placed on deposit.

(f) Whether the entity has a contractual obligation to compensate its clients if the deposit-holding bank fails.

(g) The status of the funds in the event of the insolvency or bankruptcy of the reporting entity.

(h) Whether the funds are available to fund general claims from creditors or are ring-fenced and only available to reimburse the clients.

The legal capacity in which the entity holds client money is also important. The following matters should be considered in this context:

(a) The terms and conditions of an agency agreement where one exists.

An agency agreement may have the effect that the risks and rewards of the client money remain with the client and may also restrict the reporting entity's control over the funds. The reporting entity will typically earn an agent's fee for providing services to the client. A fee earned in exchange for services is not the same as obtaining the benefits associated with ownership of the funds.

(b) The entity may hold the funds as a trustee or in a similar fiduciary capacity, supported by law.

Such arrangements may serve to ring-fence client monies and will also be relevant to the evaluation of risks and rewards and of control. In these cases, the entity has fiduciary responsibilities and is obliged to discharge them with due care. This fiduciary duty is not the same risk as the risk of ownership of the funds (an example of the latter being credit risk).

(c) Specific regulations applicable to the arrangements, which may for example specify the type of bank account in which funds are to be held and restrict the use of those funds.

If the entity is a regulated entity, the regulator may establish specific rules to protect customer assets which will be relevant to the application of the recognition criteria (e.g., rules on using separate legal trust client bank accounts and restrictions on commingling of funds).

The Group's Discussion

The Group agreed with the analysis, noting that the matters outlined in the analysis are important when applying the control and benefit concepts to the client money arrangements.

One Group member noted that it might also be useful to consider whether the entity should recognize a financial liability payable to the client, for example, through its responsibility of safe-keeping the client's money. If so, there would also be a financial asset for the client money held to satisfy that liability. Another Group member further commented that when the asset is recognized, the criteria described in the analysis are also important to assess whether the asset is restricted.

Several Group members noted that it is important to consider all the facts and circumstances related to the client arrangement. The entity may obtain a fee in the form of interest income from holding the client money without controlling the funds. In addition, the entity should consider the applicable law and regulations when reviewing the contract terms to determine whether an asset should be recognized.

One Group member also provided an example in the banking sector where a bank receives cash as collateral in a securities lending arrangement. In this situation, the bank generally recognizes the cash collateral received as an asset and an obligation on its balance sheet.

Issue 2: Where client money is recognized as an asset, can it be offset against the corresponding liability to the client on the statement of financial position?

Analysis

Paragraph 42 of IAS 32 *Financial Instruments: Presentation* permits the offset of financial assets and financial liabilities when "an entity currently has a legally enforceable right to set off the recognized amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously."

Client money will ordinarily be held in a bank account with a third-party financial institution and hence the financial asset and financial liability will be due from and due to different counterparties. Offsetting will, therefore, not be appropriate.

The Group's Discussion

The Group agreed with the analysis. One Group member observed that there generally is no legally enforceable right to offset financial assets and financial liabilities when the "due from" and "due to" amounts are with different counterparties.

Several Group members considered practical examples of client money. One Group member observed that in the investment fund industry, investors typically make investments in a fund through an investment manager. The money invested by the investors is put into a separate trust account. The investment manager will recognize on its balance sheet an asset cash held-in-trust and a liability for a corresponding amount. A similar observation was made by another Group member that the client money in the brokerage account is recognized as an asset and obligation by the broker-dealer. Another Group member commented on a trust mechanism set up by the National Energy Board[3] (NEB) in the energy industry. Entities that own regulated pipelines collect funds from their customers for future betterment of their assets. The funds are held in a trust. Although the investment strategy is set by the entity owning the assets, the timing and the amount of disbursement from the trust is controlled by the NEB. Since the funds are not controlled by the entities with the pipelines, the funds held-in-trust are not recognized as assets on these entities' balance sheets.

Issue 3: What disclosures should be made for client money arrangements?

Analysis

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[3] The National Energy Board is Canada's energy and safety regulator. It regulates the construction and operation of oil and natural gas pipelines crossing provincial or international borders

An entity's accounting policy for client money should be applied consistently and disclosed in accordance with paragraph 117 of IAS 1 *Presentation of Financial Statements* if significant.

If the client money arrangements are significant, the entity should also disclose the judgments made in the process of applying the entity's accounting policy and that have the most significant effect on the amounts recognized in the financial statements.

Additional disclosures may be necessary in some circumstances, such as:

- Restricted cash: if client money is recognized as an asset on an entity's financial statements, it may be necessary to disclose the existence of restricted cash and cash equivalents as required by IAS 7.48.
- Disclosure by trustees, such as banks that engage in significant trust activities and holds third-party assets: these third-party assets are not included in the entity's statement of financial position. These entities should consider disclosure of those activities. Disclosure of the nature and extent of such activities may be in the overall interest of the fair presentation of the accounts because of the potential liability if the entities were to fail in their fiduciary duties.

The Group's Discussion

The Group agreed with the analysis. The required disclosures provide useful information on the risks and obligations taken by the entity holding client money.

One Group member noted that restricted cash is often erroneously recorded as cash equivalents and that due to its restricted nature, it should usually not be presented as cash and cash equivalents. The change in the restricted cash should be separately reported by the entity in the statement of cash flows. Another Group member commented that IFRS 12 *Disclosure of Interests in Other Entities* also requires disclosure on the nature and extent of restrictions on the entity's ability to access or use assets in a group.

Overall, the Group's discussion of the issues raises awareness about the factors to be considered to account for client money and related disclosure requirements. No further action was recommended to the AcSB.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IFRS 16 and IAS 38: Cloud Computing Arrangements

In January 2019, the Group was provided with an update on this issue. The IFRS Interpretations Committee discussed the AcSB's submission on November 2018 and issued a tentative agenda decision.

At its March 2019 meeting, the IFRS Interpretations Committee finalized its agenda decision. The agenda decision clarifies how an entity should apply existing IFRS Standards to determine whether a customer receives a software asset at the contract commencement date or a service over the contract term.

Cryptocurrencies

In June 2018, the Group was provided an update on its recommendation to the AcSB regarding the issue of holdings of cryptocurrencies.

In November 2018, the IASB decided not to add to its work plan a project on holdings of cryptocurrencies or initial coin offerings but instead, monitor the development of crypto assets. However, the IASB requested that the IFRS Interpretations Committee issue an agenda decision to explain how entities should apply existing IFRS Standards to holdings of cryptocurrencies.

At its June 2019 meeting, the IFRS Interpretations Committee finalized its agenda decision, concluding that IAS 2 *Inventories* applies to cryptocurrencies when they are held for sale in the ordinary course of business. If IAS 2 is not applicable, an entity applies IAS 38 *Intangible Assets* to holdings of cryptocurrencies. The agenda decision also highlights disclosure requirements that are applicable to holdings of cryptocurrencies, including the requirement in IAS 1 *Presentation of Financial Statements* to provide additional information that is relevant to an understanding of an entity's financial statements.

Representatives of the Canadian Securities Administrators (CSA) also commented on the outcome of the agenda decision and encouraged reporting issuers to reach out to their local securities regulator if they have any questions regarding the financial reporting approach. The CSA representatives emphasized the importance of disclosing additional information that will be relevant to financial statement users. For example, their view is that disclosing the quantity of the specific types of cryptocurrencies held is relevant information. Also, the agenda decision clarifies there are a few possible accounting approaches depending on the circumstances, one of which includes considering the requirements in paragraph 3(b) of IAS 2 to measure at fair value less costs to sell if the entity acts as a broker-trader of cryptocurrencies. Therefore, it is important that an entity discloses the basis for why a particular approach is applied.

Cryptocurrencies – Other Considerations

At its January 2019 meeting, the Group discussed a fact pattern of a commodity broker-trader who trades in cryptocurrencies and measures them at fair value less costs to sell.[4] The Group recommended that the AcSB staff clarify whether the IFRS Interpretations Committee's tentative agenda decision on "Physical settlement of contracts to buy or sell a non-financial item" applies to a situation involving a commodity-broker trader. The IFRIC staff paper (AP11) for the March 2019 meeting noted that the application of the agenda decision to commodity broker-dealers is beyond the scope of the submission.

IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation

At the January 2019 meeting, the AcSB staff reported that the AcSB submitted this issue to the IFRS Interpretations Committee for consideration.

The IFRS Interpretations Committee discussed the AcSB's submission in June 2019 and issued a tentative agenda decision, concluding that applying IAS 41 *Agriculture*, an entity either capitalizes subsequent expenditure or recognizes it as an expense when incurred. Furthermore, entities would

[4] Refer to the Group's discussion on "Cryptocurrencies – Other Considerations."

also disclose the selected accounting policy applying paragraphs 117-124 of IAS 1 *Presentation of Financial Statements* if that disclosure would assist financial statement users in understanding how those transactions are reflected in reported financial performance. Stakeholders are encouraged to write to the IFRS Interpretations Committee by August 20, 2019 if they have any concerns with the tentative agenda decision.

IAS 16: Capitalization of Costs

At the January 2018 meeting, the AcSB staff reported that the AcSB had raised this issue and other input from the Group on the proposals through its October 2017 response letter to the IASB's Exposure Draft, "Property, Plant and Equipment – Proceeds before Intended Use (Proposed amendments to IAS 16)."

After considering stakeholders' responses, the IASB tentatively decided to proceed with the proposed amendments with some modifications (refer to June 2019 IASB Update). The IASB will be discussing due process steps at a future meeting.

OTHER MATTERS

Lessee's Incremental Borrowing Rate

In June 2019, the IFRS Interpretations Committee published a tentative agenda decision on a lessee's incremental borrowing rate. The IFRS Interpretations Committee observed that the definition of a lessee's incremental borrowing rate in IFRS 16 does not explicitly require a lessee to determine its incremental borrowing rate to reflect the interest rate in a loan with a similar payment profile to the lease payments. Stakeholders are encouraged to write to the IFRS Interpretations Committee by August 20, 2019 if they have any concerns with the tentative agenda decision.

Reminders on IASB® Documents for Comments

In May 2019, the IASB issued two standards-related exposure drafts:

- Annual Improvements to IFRS Standards 2018-2020 – comments are due August 20, 2019. The proposed amendments clarify wording or minor unintended consequences in IFRS Standards. This year's annual improvements contain four proposed amendments, three of which relate to IFRS 9 *Financial Instruments,* IFRS 16 *Leases* and IAS 41 *Agriculture*.
- Reference to the Conceptual Framework (Proposed amendments to IFRS 3) – comments are due September 27, 2019. The amendments would update a reference to the *Conceptual Framework for Financial Reporting* without changing the accounting requirements for business combinations.

Stakeholders are encouraged to submit their comments to the IASB, and also to the AcSB's corresponding Exposure Drafts, by the comment period deadline.

Proposed Amendments to IFRS 17 *Insurance Contracts*

The IASB published its Exposure Draft, "Amendments to IFRS 17" at the end of June 2019. The proposals are intended to respond to concerns and challenges raised by stakeholders as IFRS 17 is being implemented.

To support Canadians during the implementation phase and ensure Canadian views are heard, the AcSB invited Darrel Scott, IASB Board Member and Advisor on the IASB's insurance project to Canada. The AcSB hosted a panel discussion in Toronto on July 18, 2019, featuring Darrel Scott and other experts from the financial reporting community. Canadian stakeholders were encouraged to attend the AcSB's panel discussion to hear valuable insights about the changes to IFRS 17 and tips to manage the implementation.

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

PRIVATE SESSION

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

IASB Documents for Comments

At its June 2019 meeting, the Group provided input on the following documents to assist in the development of the AcSB's response letters:

- IASB Exposure Draft, "Annual Improvements to IFRS Standards 2018-2020"; and
- IASB Exposure Draft, "Reference to the *Conceptual Framework* (Proposed amendments to IFRS 3)".