

IFRS® Discussion Group

Report on the Public Meeting

May 20, 2021

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.

ITEMS PRESENTED AND DISCUSSED AT THE MAY 20, 2021 MEETING

[IAS 28: Equity Method Accounting on an Investment in Common and Preferred Shares](#)

[IAS 38: Configuration and Customization Costs in a Cloud Computing Arrangement](#)

[IAS 7, IAS 32, and IAS 33: Issuer's Accounting for Subscription Receipts](#)

[Accounting for Standby Costs and Penalties Incurred under a Force Majeure Clause](#)

PREVIOUS ITEMS DISCUSSED BY THE GROUP

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

OTHER MATTERS

[Regulatory Assets and Regulatory Liabilities](#)

[Business Combinations under Common Control](#)

[Lack of Exchangeability](#)

[Third Agenda Consultation](#)

Disclosure Requirements in IFRS Standards, a Pilot Approach

PRIVATE SESSION

IASB Documents for Comments

ITEMS PRESENTED AND DISCUSSED AT THE MAY MEETING

IAS 28: Equity Method Accounting on an Investment in Common and Preferred Shares

Under IAS 28 *Investments in Associates and Joint Ventures*, an investment in an associate or a joint venture is accounted for using the equity method of accounting. Using this method, an investment in an associate or a joint venture is initially measured at cost. Subsequently, the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the acquisition date.

Per paragraph 12 of IAS 28, “When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments.” However, paragraph 13 of IAS 28 states: “In some circumstances, an entity has, in substance, an existing ownership as a result of a transaction that currently gives it access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the returns.” IAS 28 does not specify the types of instruments that the entity may consider as in-substance existing ownership interests.

The Group considered the following fact patterns and discussed how an investor's share of the investee's income or loss should be calculated under the equity method when the investment includes both voting common shares and non-voting preferred shares of the investee.

Fact Pattern for Issue 1

- Company A holds a combination of common shares and preferred shares in Company B. Company A has 20 per cent voting rights of Company B through its investment in common shares.
- The preferred shares are non-voting but are convertible into common shares on a one-to-one basis at the option of the holder. If all its preferred shares are converted, Company A will increase its voting rights of Company B to 30 per cent.
- The preferred shareholders are not obligated to fund Company B's losses. They have no liquidation preferences or preference in the event of distribution. Distributions are at Company B's discretion. If a preference dividend is declared, it is calculated based on a percentage of Company B's available profits.
- Assume all other facts and circumstances support Company A having significant influence over Company B and Company A does not control Company B.

Issue 1: Should Company A's share of investment income or loss using the equity method include the preference shares held in Company B?

View 1A – No, the preferred shares should not be included when calculating Company A's share of investment income or loss in Company B

- Proponents of this view think the preferred shares do not represent existing ownership rights for the following reasons:
 - (a) Preferred shareholders are not obligated to fund losses of investees. Therefore, they are limited in their exposure to Company B's losses;
 - (b) The value of preferred shares generally does not fluctuate significantly based on the market value of the entity. Therefore, the preferred shareholders are shielded from direct exposure to gains or losses on their investment or fluctuations in fair value in Company B's net assets, except in the event of liquidation; and,
 - (c) Given a lack of guidance on what constitutes exposure to investee's rights to profit or losses in IFRS, it is unclear whether the exposure to discretionary dividend income or potential exposure to a liquidation event is sufficient to qualify these preferred shares as existing ownership.
- Therefore, proponents of this view think the preferred shares do not represent existing ownership rights and should not be included when calculating Company A's share of investment income or loss in Company B.

View 1B – Yes, the preferred shares should be included when calculating Company A's share of investment income or loss in Company B

- Proponents of this view considered the common shares that can be converted from preferred shares at the option of the holder. They note these common shares can give Company A additional voting power and can create exposure to Company B's profit and losses. Furthermore, the lack of protection in the event of liquidation exposes Company A to a potential loss of investment in Company B.
- As such, Company A's exposure to Company B's profit, losses, and fluctuations in fair value of net assets provides, in combination with other rights, present ownership interest in Company B. Therefore, proponents of this view think these preferred shares should be included when calculating Company A's share of investment income or loss in Company B.

The Group's Discussion

Group members offered different views on this issue.

Most Group members supported View 1A. In reaching this conclusion, these Group members cited the non-voting feature of preferred shares and the resulting inability to influence the investee to distribute returns as being important to their decision. They thought that given Company B has discretion to distribute profits, the preferred shareholders cannot influence Company B in making the distribution decision. As such, preferred shares do not give their holders access to Company B's returns and are not an in-substance existing ownership in Company B as described in paragraph 13

of IAS 28. Considering paragraph 12 of IAS 28, only Company A's common share interests should be considered when calculating Company A's share of investment income or loss in Company B. Some Group members also questioned whether the preferred shares are akin to common shares as it is unclear whether any profit from Company B will be distributed to preferred shareholders considering the preference dividends are not mandatory or cumulative and may not be paid in the event of liquidation.

Some Group members preferred View 1B. These Group members considered the voting rights to be a separate issue. They viewed the preferred shares as economically similar to the common shares based on the features described in the fact pattern, such as no liquidation preference, similar subordination and rights to a percentage of Company B's profits. Given this similar economic exposure, they thought the preferred shares should be included when calculating Company A's share of investment income or loss in Company B.

One Group member also commented that there are two distinct assessments of potential voting rights in the analysis:

- the assessment of whether potential voting rights contribute to significant influence; and
- whether potential voting rights should be considered an existing ownership under the equity method of accounting.

This Group member noted that the potential voting rights in preferred shares may contribute to an entity having significant influence over an investee. However, it does not automatically mean that the preferred shares are existing ownership interests to be included in the calculation of the investor's share in its investee's income or loss.

Fact Pattern for Issue 2

Similar to Fact Pattern for Issue 1, except the shareholders agreement for the preferred shares contains the following terms:

- (a) a liquidation preference over common shareholders as first-priority,
- (b) non-redeemable but require annual dividend payments based on a set coupon rate. There is no provision for discretionary dividends,
- (c) convertible into common shares on a one-to-one basis at the option of the holder,
- (d) non-voting but once converted into common shares, each common share is entitled to one vote, and
- (e) no redemption clauses, other than for liquidation events

Issue 2: Based on this revised fact pattern, should Company A's share of investment income or loss using the equity method include the preference shares held in Company B?

View 2A – No, the preferred shares should not be included when calculating Company A's share of investment income or loss in Company B

- Proponents of this view think the preferred shares do not represent existing ownership rights for the following reasons:
 - (a) Preferred shares have priority on distributions and payments on liquidation over common shareholders, which limits a preferred shareholder's exposure to Company B's losses as the initial investment is recovered as the first priority;
 - (b) Preferred shareholders are not obligated to fund losses of investees; and
 - (c) Contractual distributions or payments on liquidation to preferred shareholders are not affected or reduced as a result of losses by Company B.
- Therefore, proponents of this view think the preferred shares do not represent existing ownership rights and should not be included when calculating Company A's share of investment income or loss in Company B.

View 2B – Yes, the preferred shares should be included when calculating Company A's share of investment income or loss in Company B

- Proponents of this view think the preferred shareholders have a right to Company B's profits through distributions and exposure to changes in fair value of the investee's assets through liquidation rights. In addition, in a liquidation event that results in net liabilities, preferred shareholders are exposed to negative changes in fair value of Company B's net assets.
- Furthermore, proponents of this view considered the common shares that can be converted from preferred shares at the option of the holder. They note these common shares can give Company A additional voting power and can create exposure to Company B's profit and losses. Furthermore, the lack of protection in the event of liquidation exposes Company A to a potential loss of investment in Company B.
- As such, Company A's exposure to Company B's profit, losses, and fluctuations in fair value of net assets provides, in combination with other rights, present ownership interest in Company B. Therefore, proponents of this view think these preferred shares should be included when calculating Company A's share of investment income or loss in Company B.

The Group's Discussion

Group members supported View 2A. They noted that the preferred shares do not represent existing ownership rights when considering features such as non-voting, liquidation preference over common shareholders, and the required dividend payments based on a coupon rate. One Group member also noted that the preferred shares do not give Company A rights to Company B's profits given the fact pattern only states the dividends are based on a set coupon rate, but does not specify that they must be paid from Company B's profit.

Overall, the Group's discussion raises awareness about whether preferred shares represent existing ownership rights to be considered when calculating the investor's share in investee's income or loss under the equity method of accounting. Some Group members observed that the diverse views on Issue 1 can be attributed to a lack of guidance in IAS 28 on what constitutes a present ownership interest. They thought this could be raised as a topic in the IASB's agenda consultation. The AcSB Chair commented the Board is aware of the issues associated with applying the equity method of accounting in IAS 28. The Board will consider the Group's discussion when drafting its response to the IASB's agenda consultation request. No further action was recommended to the Board.

IAS 38: Configuration and Customization Costs in a Cloud Computing Arrangement

The IFRS® Interpretations Committee (the Interpretations Committee) received a submission about a customer's accounting for costs of configuring or customizing the supplier's application software in a Software as a Service (SaaS) arrangement.

In the fact pattern described in the submission:

- a) A customer enters into a SaaS arrangement with a supplier. The contract conveys to the customer the right to receive access to the supplier's application software over the contract's term. That right to receive access does not provide the customer with a software asset and, therefore, the access to the software is a service that the customer receives over the contract term.
- b) The customer incurs costs of configuring or customizing the supplier's application software to which the customer receives access. The request describes configuration and customization as follows:
 - i. Configuration involves settings various "flags" or "switches" within the application software, or defining values or parameters, to set up the software's existing code to function in a specified way.
 - ii. Customization involves modifying the software code in the application or writing additional code. Customization generally changes, or creates additional, functionalities within the software.
- c) The customer receives no other goods or services.

In analyzing the submission, the Interpretations Committee considered:

- a) whether, applying IAS 38 *Intangible Assets*, the customer recognizes an intangible asset in relation to configuration or customization of the application software.
- b) if an intangible asset is not recognized, how the customer accounts for the configuration or customization costs.

The Interpretations Committee discussed these issues at its December 2020 and March 2021 meetings. Subsequently, the Interpretations Committee published an [agenda decision](#) in April 2021.

The Group considered the analysis included in this agenda decision as summarized below and discussed the application of this agenda decision in Canada.

Issue 1: Does the customer recognize an intangible asset in relation to configuration or customization of the application software?

Analysis

- The customer recognizes an item as an intangible asset when the customer demonstrates that the item meets both the definition of an intangible asset and the recognition criteria in paragraphs 21-23 of IAS 38. IAS 38 notes that an asset is a resource controlled by the customer and paragraph 13 of IAS 38 specifies that the customer controls an asset if it has “the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.”
- In the fact pattern described in the Interpretation Committee submission, the supplier controls the application software while the customer only has access. The assessment of whether configuring or customizing software results in an intangible asset for the customer depends on the nature and output of the configuration or customization performed.
- The Interpretations Committee observed that, in the SaaS arrangement described in the submission, the customer often would not recognize an intangible asset because it does not control the software being configured or customized and those configurations or customizations do not create a resource controlled by the customer that is separate from the software.
- The Interpretations Committee noted that in some circumstances, however, the arrangement may result in, for example, additional code from which the customer has the power to obtain the future economic benefits and to restrict others’ access to those benefits. In that case, in determining whether to recognize the additional code as an intangible asset, the customer assesses whether the additional code is identifiable and meets the recognition criteria in IAS 38.

The Group’s Discussion

Group members agreed with the analysis.

Some Group members highlighted that cloud computing arrangements often include multiple elements that need to be closely examined by the customer. For example, a cloud computing arrangement may include tangible elements like the supporting infrastructure and intangible elements such as software. In these cases, the customer should assess whether it controls the individual elements to determine whether an intangible asset should be recognized.

The Group then considered other arrangements where the control assessments are more complex compared to the fact pattern contemplated in the agenda decision. Several Group members noted that in some cases, the customer may have the ability to take possession of the supplier’s software and host the software in a third-party’s cloud environment or on its own infrastructure. In other cases, a customer may develop additional programs and software modules to integrate its own system with the supplier’s system and database, which can be separated from the supplier and applied to another cloud environment or to its own system. These Group members noted in these cases, it is important to understand the customer’s rights in the arrangements. They also thought that a

customer's right to possess the supplier's software or the underlying codes for software modules and the right to transfer the software to another environment are relevant factors to consider when assessing control.

A few Group members viewed the underlying economics between a customer owning the software license and accessing the software in a SaaS arrangement to be similar. Therefore, they noted that the different accounting treatments on the configuration and customization costs may not reflect the similar economics. One Group member thought that this concern may be more effectively addressed through a future standard-setting project. Another Group member highlighted that the Interpretations Committee's March 2019 [agenda decision](#) on "Customer's right to receive access the supplier's application software hosted on the cloud" provides useful guidance to help customers assess whether the cloud computing arrangement contains a software asset.

Issue 2: If an intangible asset is not recognized, how does the customer account for the configuration or customization costs?

Analysis

- If the customer does not recognize an intangible asset in relation to configuration or customization of the application software, the customer recognizes the costs as an expense when it receives the configuration or customization services. In assessing when to recognize the costs as an expense, IAS 38 requires the customer to determine when the supplier performs the configuration or customization services in accordance with the contract to deliver those services.
- IAS 38 does not provide guidance on the identification of services the customer receives and determining when the supplier performs those services. The Interpretations Committee observed that IFRS 15 *Revenue from Contracts with Customers* includes requirements associated with identifying promised goods or services in a contract with a customer. For the fact pattern described in the submission, the requirements in IFRS 15 provide guidance on determining when the supplier performs the configuration or customization services in accordance with the contract to deliver those services.
- If the contract specifies that the application software supplier also performs the configuration or customization service, then the customer applies paragraphs 69 and 69A of IAS 38 and determines when the supplier performs those services in accordance with the contract to deliver them.
 - i. If the services the customer receives are distinct, then the customer recognizes the costs as an expense when the supplier configures or customizes the application software.
 - ii. If the services the customer receives are not distinct (because those services are not separately identifiable from the customer's right to receive access to the supplier's application software), then the customer recognizes the costs as an expense when the supplier provides access to the application software over the contract term.
- If the contract to deliver the configuration or customization services to the customer is with a third-party supplier, the customer applies paragraphs 69 and 69A of IAS 38 and determines

when the third-party supplier performs those services in accordance with the contract to deliver them. In applying these requirements, the customer recognizes the costs as an expense when the third-party supplier configures or customizes the application software.

- If the customer pays the supplier of the configuration or customization services before receiving those services, it recognizes the prepayment as an asset.

The Group's Discussion

Some Group members observed that using IFRS 15 to determine whether the supplier performs configuration or customization services may be a change in approach for many entities. In these cases, the customer may need to evaluate its contract review process and procedures to incorporate this step when assessing at what point these implementation costs are recognized as an expense.

A few Group members noted the inconsistent accounting outcomes for the same implementation services performed by the third-party vendor or the cloud supplier. The implementation costs paid to a third-party vendor are expensed as incurred. However, if the same implementation services are performed by the cloud supplier, the implementation costs are combined with the cloud supplier's hosting fee when the services are not distinct. While acknowledging this inconsistency, some Group members observed that it is uncommon in practice for the cloud supplier to perform the implementation services. These Group members noted that companies often use internal IT teams to configure and customize the application software. In addition, one Group member commented that internal costs account for most of the implementation costs, comparing to the cost incurred on external consultants and software suppliers.

One Group member commented that when a customer pays a third-party to customize the supplier's software, the customer should consider whether it controls certain elements in the cloud computing arrangement. For example, a third-party vendor could have created a separate software asset that is controlled by the customer.

Issue 3: When should the agenda decision be applied?

The Group's Discussion

Several Group members said that "sufficient time" required to implement this agenda decision depends on a company's own facts and circumstances. They noted that the effort required to complete the implementation of the agenda decision will impact what represents "sufficient time".

A representative of the Canadian Securities Administrators commented that entities that have not yet implemented this agenda decision should consider applying the requirements in paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to disclose information on the expected timing and the possible impact that applying this agenda decisions will have on their financial statements.

The Group's discussion of the three issues raises awareness about the Interpretations Committee's agenda decision on the accounting for configuration or customization costs in a cloud computing arrangement. No further action was recommended to the AcSB.

IAS 7, IAS 32, and IAS 33: Issuer's Accounting for Subscription Receipts

A subscription receipt is a financial instrument issued by a company to investors in return for cash consideration and is governed by a subscription receipt agreement. Subscription receipts are converted into a fixed number of a company's common shares upon completing a defined transaction, such as an acquisition of a specific target company or a financing. If the defined transaction is not completed, the company will redeem the subscription receipts and refund the investors' original purchase price plus interest.

Cash received from the issuing subscription receipts is required to be used for the defined transaction and is held in escrow until such time that the conditions for release are either met or the transaction fails to materialize. While held in escrow, the funds are invested in certain specified investments such as short-term obligations guaranteed by the Government of Canada (e.g., guaranteed investment contracts (GICs)), often stipulated by the subscription receipt agreement.

With the increase in acquisitions and market activity in Canada, subscription receipt transactions are becoming a more prevalent form of financing. As a result, several questions have arisen about accounting for such transactions. The Group considered the following fact pattern and discussed questions such as the classification of such subscription receipts on the balance sheet, their measurement, their impact on the cash flow statement, and their impact on earnings per share (EPS).

Fact Pattern 1

- On December 15, 20X2, Company A completed a public offering of 1 million subscription receipts for gross proceeds of CAD\$1 million (for simplicity, this example ignores transaction costs). Company A raised funds to complete an acquisition of a target company before January 31, 20X3 (the deadline). Company A's functional currency is CAD and its fiscal year end is December 31, 20X2.
- As at December 31, 20X2, the completion of the business combination was subject to closing conditions, compliance with which is outside Company A's control. In other words, completion of the business combination is not entirely within Company A's control.
- As part of the terms of the subscription receipts, the gross proceeds were placed into escrow and will be released to Company A upon closing of the acquisition. The holder of each subscription receipt is entitled to receive one common share at closing of the acquisition. The common shares are neither puttable by the holder nor of the type described in paragraph 16C of IAS 32 *Financial Instruments: Presentation*.
- If any one of the following events occurs, the escrowed proceeds, together with any interest earned thereon, will be returned on a pro-rata basis to holders of the subscription receipts:
 - a) the acquisition does not close by the deadline;
 - b) the acquisition agreement is terminated before the deadline; or
 - c) Company A announces its intention not to proceed with the acquisition before the deadline.

- While held in escrow, the funds will be invested in various permitted investments specified by the subscription receipts agreement (e.g., GICs). Company A has assessed and concluded that it controls the cash held in escrow and receives the benefits from such cash. Therefore, the cash held in escrow meets the definition of an asset because Company A:
 - (i) has discretion in investing the cash held in escrow within the applicable parameters; and
 - (ii) retains the funds and the interest earned on the escrowed funds upon the successful completion of the acquisition.
- Company A also concluded it incurs an obligation:
 - (i) to pay to the subscription receipt holders the funds held in escrow in the event the transaction does not occur; and
 - (ii) to pay any shortfall between the amount owed to subscription receipt holders as described above and the funds held in escrow.
- On January 5, 20X3, Company A completes the acquisition of the target company, the funds are released from escrow and Company A issues the common shares to the holders of the subscription receipts in exchange thereof.

Issue 1: How should Company A's subscription receipts be classified for recognition and measurement purposes in the December 31, 20X2 financial statements?

Analysis

- The terms of the subscription receipts contain two settlement alternatives that depend on whether the specified business combination occurs within the specified time frame. If Company A does not complete the business combination, the subscription receipts will be settled in cash. However, if the business combination is completed, Company A will settle the subscription receipts by issuing its own equity instruments. Furthermore, the closing of the business combination is an uncertain event on December 31, 20X2, which is outside the control of Company A and the subscription receipt holders. Therefore, Company A should consider paragraph 25 of IAS 32 that addresses the issuer's classification of financial instruments with contingent settlement provisions.
- In accordance with paragraph 25 of IAS 32, as Company A does not have the unconditional right to avoid delivering cash and none of the exceptions described in paragraphs 25(a)-(c) are met, Company A should classify the subscription receipts as a financial liability, or at least conclude that there is a liability component.
- Since Company A may have to issue its own equity instruments to settle the subscription receipts outstanding, it should also consider the fixed-for-fixed condition in paragraphs 21- 22 of IAS 32 on contracts that are subject to settlement in its own equity instruments. Given the number of shares to be issued in settlement of the subscription receipts is fixed, Company A concludes that the settlement in shares represents an equity feature and the subscription receipts are therefore a compound instrument.

- At inception of the instrument, Company A allocates the initial proceeds of CAD \$1million between the liability and equity components. In accordance with IFRS 9, the liability component is initially recognized at its fair value with any difference between the fair value of the liability component and the proceeds of CAD \$1million being allocated to the equity component as described in paragraph 31 of IAS 32. Given the short time frame between the initial issuance of the subscription receipt (December 15) and when the contingency is resolved (January 31), it is reasonable to expect that most of the proceeds would be allocated to the fair value of the liability component.

The Group's Discussion

Group members agreed with the analysis.

One Group member observed that in a few cases, depending on the terms of the escrow agreement, a company may conclude that it does not have control over cash held in escrow and thus, does not recognize cash held in escrow as an asset.

The Group then discussed the following variations to Fact Pattern 1:

Issue 1A: Are there situations different from Fact Pattern 1 where the settlement in shares would not represent an equity component but would instead be an embedded derivative?

Fact Pattern 1A

Instead of Canadian dollars, the gross proceeds for the subscription receipts are USD \$1 million. Company A promises to return that amount to the holders if the business combination does not complete. Company A has a CAD functional currency.

Fact Pattern 1B

The subscription receipts will convert into instruments that:

- a) could be puttable at the holders' option (as set out in paragraph 16A of IAS 32); or
- b) could impose upon Company A an obligation to deliver a pro rata share of net assets as set out in paragraph 16C of IAS 32.

Analysis

- For Fact Pattern 1A, since the monetary amount to be exchanged is not fixed in the entity's CAD functional currency, the fixed-for-fixed condition described in paragraphs 21 and 22 of IAS 32 is not met. Thus, Company A should consider the conversion feature a financial liability.
- For Fact Pattern 1B, Paragraph 22A of IAS 32 notes that any conversion features that result in the types of financial instruments described in (a) and (b) should be considered a financial liability of the issuer, and not equity.
- For both Fact Patterns 1A and 1B, Company A should consider the guidance in IFRS 9 *Financial Instruments* related to embedded derivatives and assess whether the embedded conversion feature is required to be separated from the host liability and accounted for as a

derivative. The embedded conversion feature is required to be separated from the host liability and accounted for as a derivative if

- (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;
 - (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - (c) the hybrid contract is not measured at fair value with changes in fair value recognized in profit or loss (paragraph 4.3.3 of IFRS 9).
- If the conditions in IFRS 9 are met, Company A can also designate the entire subscription receipt contract as at fair value through profit or loss, except for changes in fair value, if any, related to changes in Company A's own credit risk, which would be reported in other comprehensive income (paragraph 4.3.5 of IFRS 9).

The Group's Discussion

Group members agreed with the analysis.

One Group member noted that in Fact Pattern 1A, the gross proceeds of the subscription receipts are denominated in US dollars, but the number of shares Company A will issue to settle the subscription receipts is fixed. Although the number of shares to be issued is fixed, the monetary amount to be exchanged is not fixed in the entity's CAD functional currency. Therefore, the fixed-for-fixed condition is not met, and the conversion feature is a financial liability.

Issue 2: How should Company A present the funds held in escrow in the cash flow statement for the period ended December 31, 20X2?

View 2A– The funds held in escrow should not be excluded from “cash and cash-equivalents” simply due to the existence of the restrictions.

- Proponents of this view think that Company A should first determine whether the investments held in escrow meet the definition of “cash and cash equivalents” in IAS 7 *Statement of Cash Flows*. Specifically, paragraph 6 of IAS 7 defines “cash equivalents” as “short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.”
- Proponents of this view think that if the funds placed into escrow are invested in investments that meet the definition of cash equivalents, then they should be included within “cash and cash equivalents” in the cash flow statement. However, Company A should disclose, with commentary by management, the amount of significant cash and cash equivalents the entity holds that are not available for use by the group in accordance with paragraph 48 of IAS 7.
- Therefore, in the statement of cash flow, Company A should reflect the cash from issuing subscription receipts as a cash inflow from financing activities with a corresponding increase in the closing balance of cash and cash equivalents.

View 2B– The funds held in escrow should be excluded from “cash and cash equivalents” due to the existence of the restrictions that requires the funds to be used for long-term investing purposes.

- Proponents of this view focus on the words in paragraph 7 of IAS 7: “Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.” They think that the nature of the restriction would mean that the amounts held in escrow would not qualify as “cash equivalents” because they are not held for “the purpose of meeting short-term cash commitments”, but rather are held for investment or other purposes – specifically, to finance the acquisition of an entity.

View 2C– Accounting policy choice

- Proponents of this view believe the guidance in IAS 7 is unclear. Therefore, Company A has an accounting policy choice between Views 2A and 2B, to be applied consistently.

The Group’s Discussion

Most Group members preferred View 2C, recognizing both View 2A and 2B have merit. They noted that because cash will only be held in escrow for a short time until the uncertainty is resolved, this could support the assessment that the funds meet the definition of cash equivalents (View 2A). Alternatively, these Group members considered that the funds held in escrow are held for acquiring an entity, not for short-term cash commitments. Therefore, this could support that the funds do not qualify as “cash equivalents” (View 2B). They highlighted the importance of clear disclosure of this accounting policy and the intended use of the funds so that financial statement users have relevant information regarding these funds.

A few Group members preferred View 2B. They noted that it is important to consider paragraph 7 of IAS 7 to assess the intent for holding the funds in escrow. Given the funds are intended for the acquisition of an entity, these Group members thought the funds do not qualify as “cash equivalents”.

Issue 3: If it is concluded that the funds held in escrow do not qualify as “cash and cash equivalents”, how should the subscription receipts be reflected in the cash flow statement for the year ended December 31, 20X2?

View 3A– Treat as cash flows from financing and investing activities

- Proponents of this view note that the issuance of the subscription receipts should be presented as a cash inflow from financing activities on Company A’s cash flow statement as it changes the size and composition of Company A’s borrowings. In addition, Company A should present a corresponding cash outflow from investing activities as the cash received was used to acquire investments not included in cash and cash equivalents.

View 3B– Treat as a non-cash transaction

- Proponents of this view consider paragraph 43 of IAS 7 which states: “Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.” Given the funds held in escrow do not qualify as “cash and cash equivalents”, they think the receipt of cash and the incurrence of the subscription receipts liability would be excluded from the cash flow statement.

View 3C– Accounting policy choice

- Proponents of this view consider the guidance in IAS 7 to be unclear. Therefore, Company A has an accounting policy choice between Views 3A and 3B, to be applied consistently.

The Group’s Discussion

Group members offered different views on this issue.

A few Group members preferred View 3A. One Group member noted the issuance of subscription receipts represents a cash inflow to Company A, albeit in escrow, and should be reflected in the cash flow statement. Other Group members noted that this view, along with the note disclosure, better reflects the cash flows behind the transaction whereby the proceeds from the subscription receipts is used to acquire investments.

Some Group members preferred View 3B. They noted that because the funds held in escrow are excluded from cash and cash equivalents, they should be excluded from the cash flow statement. One Group member also considered paragraph 22 of IAS 7 to be relevant, where the cash flows arising from operating, investing and financing activities may be reported on a net basis when “the cash receipts and payments for items in which the turn-over is quick, the amount is large, and the maturities are short.”

Other Group members noted the merits in both Views 3A and 3B and therefore, thought an accounting policy choice is appropriate.

Issue 4: How should Company A treat the subscription receipts when calculating basic and diluted EPS as at December 31, 20X2?

Analysis

- IAS 33 *Earnings per Share* does not provide specific guidance regarding the treatment of subscription receipts. However, IAS 33 does provide guidance on “contingently issuable ordinary shares” which are defined as “ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions in a contingent share agreement” (paragraph 5 of IAS 33). The subscription receipts do not qualify as contingently issuable ordinary shares because the shares are not issuable for little or no consideration – the consideration has been prepaid. Nonetheless, the subscription receipts and contingently issuable shares are similar in that both instruments result in issuing common shares only on the satisfaction of specified conditions. Therefore, it is worth considering the guidance in IAS 33 on contingently issuable shares by analogy.
- With respect to the impact of the subscription receipts on basic EPS, Company A considers paragraph 24 of IAS 33, requiring that the contingently issuable shares be treated as outstanding and included in the calculation of basic EPS only from the date when all necessary conditions have been satisfied (i.e., the events have occurred). Because the acquisition has not occurred by December 31, 20X2, the contingently issuable shares would not be included in basic EPS for the year ended December 31, 20X2. They will be included in basic EPS from the date when all necessary conditions have been met (i.e., the acquisition closes).

- Regarding the computation of diluted EPS, IAS 33 recognizes that contingently issuable ordinary shares may be issued based on conditions relating to future earnings, future market prices or other conditions. Paragraph 56 of IAS 33 explains that:

“In other cases, the number of ordinary shares contingently issuable depends on a condition other than earnings or market price (for example, the opening of a specific number of retail stores). **In such cases, assuming that the present status of the condition remains unchanged until the end of the contingency period, the contingently issuable ordinary shares are included in the calculation of diluted earnings per share according to the status at the end of the reporting period.**” (emphasis added)

- Given that the acquisition has not occurred on December 31, 20X2, the status of the contingently issuable shares is that they are not issuable. Therefore, they would be excluded from diluted EPS for the year ended December 31, 20X2. Once the common shares are issued on January 5, 20X3, they will impact the calculation of diluted EPS from January 1, 20X3.

The Group’s Discussion

Group members agreed with the analysis.

Some Group members noted that although subscription receipts do not impact basic and diluted EPS for the year ended December 31, 20X2, there could be a dilutive impact on existing shareholders when the acquisition is completed on January 5, 20X3. These Group members thought that Company A should consider communicating to financial statement users information about this anticipated dilution event and forecasted impact on EPS in its management discussion and analysis.

Overall, the Group’s discussion raises awareness on the issuer’s accounting for subscription receipts and the related impact on the cash flow statement and EPS. No further action was recommended to the AcSB.

Accounting for Standby Costs and Penalties Incurred under a Force Majeure Clause

A force majeure clause is generally included in a contract to relieve a party from performing its contractual obligations when an unexpected, external event occurs that prevents it from performing¹.

In the fight against COVID-19, various levels of government have imposed measures such as closing construction sites and requiring additional safety measures in many workplaces. These measures may trigger *force majeure* clauses or other similar clauses in many construction and other long-term contracts. Some contracts may allow the affected party to claim financial compensation from the non-affected party under force majeure clauses if the affected party can prove that the force majeure event has prevented it from performing its contractual obligations².

¹ Norton Rose Fulbright, [“Q&A on COVID-19-related force majeure claims,”](#) Norton Rose Fulbright website, May 2020.

² Ibid.

In a construction contract, examples of financial compensation that an affected contractor may claim from its customer include:

- payments to the contractor or supplier compensating for their employees being idle while a job site is closed;
- costs of providing additional COVID-19 protection; and
- compensation for productivity losses such as the loss in productivity when employees of the contractor or supplier work from home rather than on the job site (or are less productive on the job site because of social distancing requirements).

The Group considered the following fact pattern where a company that owns a significant asset under construction incurs standby costs and other costs to be paid to the contractor under a force majeure clause or some other similar contractual clauses. The Group discussed the accounting for these costs by the owner of the asset.

Fact Pattern

- Company A owns a major infrastructure asset under construction. The contract with the construction company, Company B, contains a *force majeure* clause that provides some relief in the event that Company B is prevented from performing construction work due to an event out of its control that cannot be avoided or mitigated (e.g. a pandemic or other global health issues such as COVID-19).
- The relief includes financial compensation to be paid to Company B by Company A for additional costs incurred by Company B, such as the payment of salaries to its employees when the job site is closed, for putting in place additional safety measures for COVID-19 protection, and for productivity losses.
- Company A accounts for its asset under construction using IAS 16 *Property, Plant and Equipment*, IAS 23 *Borrowing Costs* and other related standards.

Issue 1: How should Company A account for costs under force majeure clauses or other similar contractual clauses, to be paid to Company B?

View 1A – These costs are not capitalizable and should be immediately expensed because they are abnormal costs incurred when constructing the asset.

- Proponents of this view consider the financial compensations Company A pays stems from a contractual clause that is not expected to be applied in ordinary situations. Therefore, they think these costs should be considered abnormal. Per paragraph 22 of IAS 16, “the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.” As such, they think these costs should not be capitalized.
- Proponents of this view also analogize to the guidance in paragraph 20 of IAS 23 that requires suspension of “capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.” Furthermore, paragraph 21 of IAS 23 states that capitalization is not suspended “when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.” Given the costs incurred under the *force*

majeure clauses are not due to delays as a necessary part of the process, they should not be capitalized.

View 1B – These costs can be capitalized as they are directly attributable to bringing the asset to the location and condition necessary for use.

- Proponents of this view note that paragraph 16 of IAS 16 states: “The cost of an item of property, plant and equipment comprises ... any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.” They note that these costs are incurred as part of the construction contract and are directly attributable to bringing the asset to the condition necessary for use. This is because if these costs are not paid, Company A may be at risk of breaching the contract, which could prevent the completion of the project.
- Proponents of this view also think the analogy to IAS 23 is inappropriate because the costs incurred under a *force majeure* clause are not incurred for holding the asset. They are incurred as part of the construction of the asset and are directly attributable to its construction.
- Therefore, these costs should be capitalized.

View 1C – Accounting for these costs will depend on facts and circumstances.

- Proponents of this view think the accounting treatment will depend on the facts and circumstances. They note that any amounts paid to a contractor for periods of time when the construction has stopped, such as during a lock-down period, should not be capitalized because they are clearly abnormal wastage that are not directly linked to the construction of the asset.
- For other costs incurred because of COVID-19, such as enhanced personal protective equipment or lower productivity due to social distancing requirements at the construction site, further analysis is needed. For example, if a contract was entered into for construction services during the pandemic, these types of costs would be embedded in the base contract price, which is capitalized as part of the cost of the asset under construction. Similarly, the proponents of this view think these types of costs should be capitalized on a contract entered into prior to the pandemic.
- In considering the facts and circumstances, proponents of this view note it is important to assess whether any costs to be capitalized are directly attributable to the construction of the asset and are not costs incurred unrelated to the actual construction of the asset.

The Group’s Discussion

Most Group members preferred View 1C, noting entities should carefully assess their specific facts and circumstances to determine the accounting for these costs. Some Group members commented that incurring standby costs to contractors when the construction site is idle are examples of abnormal waste and should be expensed. On the other hand, other costs incurred to provide protection against COVID-19, such as protective equipment, or labour costs incurred due to social distancing measures may qualify for capitalization. These Group members also thought that following View 1A to treat all costs under *force majeure* clauses as abnormal may not be appropriate as the inclusion of such costs in the contract with the supplier may become more common (i.e. normal),

especially as a result of the COVID-19 experience. Therefore, entities should carefully review the wording in their contracts to consider whether these costs are directly attributable to the construction of the asset. In making this assessment, these Group members noted that factors such as materiality, and the period of business interruptions should be considered.

A few Group members preferred View 1B (i.e. should be capitalized). Based on the fact pattern presented, they thought the additional costs incurred are part of the payments made to the contractor to construct the asset. Paragraph 16(a) of IAS 16 is clear that the costs of the property, plant and equipment comprises the purchase price. Therefore, these costs should be capitalized as part of the property, plant, and equipment.

Issue 2: If certain costs are capitalized, how does this impact Company A's assessment of impairment of the asset under construction?

Analysis

- Paragraph 9 of IAS 36 *Impairment of Assets*, requires Company A to “assess at the end of each reporting period whether there is any indication that an asset may be impaired.” Paragraph 14 of IAS 36 provides evidence from internal reporting indicating that an asset may be impaired. This includes “cash flows for acquiring the asset, or subsequently cash needs for operating or maintaining it, that are significantly higher than those originally budgeted.”
- The additional costs paid to Company B under a *force majeure* or other similar clause may be a potential indicator of impairment of the asset under construction. Company A needs to further analyze its own circumstances to determine whether these potential indicators of impairment are actual indicators of impairment warranting an impairment test in accordance with IAS 36.
- In assessing its own circumstances, Company A should consider the following factors, among others:
 - the relative amount of the additional costs to be paid to Company B;
 - the results of previous impairment tests, including the amount by which the recoverable amount exceeded the carrying value of the asset or cash-generating unit (CGU);
 - the nature, timing and impact on Company A and/or the CGU to which the asset relates, including the impact of potential delays in construction of the asset; and
 - the potential government support or insurance proceeds

The Group's Discussion

Group members agreed with the analysis. One Group member noted that this analysis is further supported by paragraph 11 of IAS 16 which states that the carrying amount of assets acquired for safety reasons should be reviewed for impairment in accordance with IAS 36. Some Group members highlighted that when considering whether potential indicators of impairment exist, entities should consider their circumstances holistically by considering all the relevant factors. Individual factors, such as the potential for government support or insurance proceeds, should not be considered in isolation when assessing whether potential impairment indicators exist.

Issue 3: When Company A receives insurance proceeds or government subsidies that are related to certain additional costs incurred and capitalized, should these proceeds and subsidies be offset against the capitalized costs?

Analysis

- When accounting for the insurance proceeds, Company A should follow paragraph 54 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The insurance proceeds should only be recognized when it is virtually certain that reimbursement will be received. When the underlying costs being reimbursed by the insurance proceeds have been capitalized, the insurance proceeds should offset against the carrying value of the asset under construction.
- When accounting for government subsidies, paragraph 24 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requires government grants related to assets be presented on the balance sheet either as deferred income (a liability) or a reduction of the carrying value of the asset. Subsequently, the government grant is recognized in profit or loss on a systematic basis over the periods in which Company A recognizes as expenses the related cost for which the government grants are intended to compensate.

The Group's Discussion

Group members agreed with the analysis.

One Group member noted that Company A should carefully review the insurance contract to understand whether the insurance is for business interruption. Insurance proceeds that compensate a company for loss recognized due to business interruption will be recognized generally as income in accordance with paragraph 65 of IAS 16.

Overall, the Group's discussion raises awareness on the accounting for standby costs and penalties incurred under force majeure and other similar clauses. 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 of the amended IAS 1 *Presentation of Financial Statements* to classify a term loan as current or non-current with the International Accounting Standards Board (IASB).

The IFRS Interpretations Committee (the Interpretations Committee) discussed this issue at its December meeting and issued a tentative agenda decision. The Board formally [responded](#) to this tentative agenda decision in February 2021. The Interpretations Committee continued its discussion on this topic at its April 2021 meeting. The Interpretations Committee confirmed its agreement with the technical analysis and conclusions in the tentative agenda decision. Nonetheless, before finalizing the agenda decision, the Interpretations Committee decided to report to the IASB:

- its technical analysis and conclusions on the matter; and

- respondents' comments on the outcomes and practical consequences of applying the amendments, highlighting those that might provide information the IASB did not consider when developing the amendments (e.g. application to entities with seasonal businesses).

The IASB will discuss the matter at a future meeting.

OTHER MATTERS

Regulatory Assets and Regulatory Liabilities

The IASB issued an Exposure Draft, "[Regulatory Assets and Regulatory Liabilities](#)." This Exposure Draft includes proposals that aim to give investors a more complete picture of the financial performance of entities subject to rate regulation. Canadian stakeholders are encouraged to submit their comments on this document by July 30, 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 by the receiving entity. Stakeholders are encouraged to submit their comments on this document by September 1, 2021.

Lack of Exchangeability

The IASB issued an Exposure Draft, "[Lack of Exchangeability](#)" to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The proposed amendments aim to help companies determine whether a currency can be exchanged into another currency, and what accounting to apply if the currency cannot be exchanged. Canadian stakeholders are encouraged to submit their comments to the IASB by September 1, 2021.

Third Agenda Consultation

The IASB recently published its Request for Information - "[Third Agenda Consultation](#)" to seek views on what its priorities should be over the next five years. Canadian stakeholders are encouraged to submit their comments to the IASB by September 27, 2021.

Disclosure Requirements in IFRS Standards, a Pilot Approach

The IASB issued an Exposure Draft, "[Disclosure Requirements in IFRS Standards, a Pilot Approach](#)" proposing new guidance for the IASB to use when developing and drafting disclosure requirements for IFRS Standards. The IASB also proposes to replace the disclosure requirements of IFRS 13 *Fair Value Measurement* and IAS 19 *Employee Benefits* with a new set of disclosure requirements developed applying the proposed guidance. Canadian stakeholders are encouraged to submit their comments to the IASB by October 21, 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 March 2021, the Group provided input on the following documents for comment to assist in the development of the AcSB’s response letters:

- IASB 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](#)”
- IASB Discussion Paper- “[Business Combinations under Common Control](#)”
- IASB Exposure Draft- “[Regulatory Assets and Regulatory Liabilities](#)”