IFRS Discussion Group

Report on the Public Meeting

September 13, 2016

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board (AcSB) regarding the identification of issues arising on the application of International Financial Reporting Standards (IFRSs) in Canada. The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the AcSB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of the AcSB and is 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 IFRSs do not purport to be conclusions about acceptable or unacceptable application of IFRSs. Only the International Accounting Standards Board or the IFRS Interpretations Committee can make such a determination.

Items Presented and Discussed at the September 13, 2016 Meeting

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ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

IFRS 6: Technical Feasibility and Commercial Viability

Under IFRS 6 *Exploration for and Evaluation of Mineral Resources,* demonstrating technical feasibility and commercial viability is important because the standard does not apply to expenditures incurred "after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable" (paragraph 5(b) of IFRS 6).

IFRS 6 does not define the term "technical feasibility" or the term "commercial viability". Also, IFRS 6 does not prescribe criteria for demonstrating the technical feasibility and commercial viability of extracting a mineral resource. Management must make judgments in applying an entity's accounting policies and identifying appropriate criteria for demonstrating technical feasibility and commercial viability.

In addition, IFRS 6 refers to "mineral resource" and does not differentiate between mineral resources and mineral reserves. The Committee for Mineral Reserves International Reporting Standards (CRIRSCO)[1] makes the distinction between a mineral reserve and a mineral resource based on the economic viability of extraction. The CRIRSCO reporting framework requires a comprehensive study performed by a qualified individual to support the determination of mineral reserves. Mining studies involve technical and economic analysis and three key types of studies are as follows:

- scoping study or preliminary economic assessment (two names for the same concept);
- pre-feasibility study (preliminary feasibility study); and
- feasibility study.

In Canada, National Instrument 43-101 *Standards of Disclosure for Mineral Projects* (NI 43-101) sets out disclosure requirements for entities with mineral projects. NI 43-101 incorporates terms and definitions specified by the Canadian Institute of Mining, Metallurgy and Petroleum (CIM). Consistent with CRIRSCO, CIM defines the term "mineral reserve" as "the economically mineable part of a measured or indicated mineral resource" and notes that the public disclosure of a mineral reserve must be demonstrated by a pre-feasibility study or feasibility study.[2] The CIM Best Practice Guideline explicitly states: "mineral resources which are not mineral reserves do not have demonstrated economic viability."[3] A scoping study or preliminary economic assessment is not sufficient to establish mineral reserves.[4]

Section 3.4(e) of NI 43-101 requires an issuer that discloses in writing the results of an economic analysis of mineral resources on a property material to the issuer, to include a prominent statement that

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1 CRIRSCO is an international initiative to standardize definitions for mineral resources, mineral reserves, and related terms for public disclosure.

2 CIM Definition Standards for Mineral Resources and Mineral Reserves (under the section, "Mineral Reserve.")

3 CIM Best Practice Guidelines: Estimation of Mineral Resources and Mineral Reserves (under the section, "Reporting," which makes reference to the requirements in NI 43-101).

4 In NI 43-101, "preliminary economic assessment" means a study, other than a pre-feasibility or feasibility study, that includes an economic analysis of the potential viability of mineral resources.

mineral resources that are not mineral reserves do not have demonstrated economic viability. Companion Policy 43-101CP discusses situations when an issuer decides to put a mineral project into production without first establishing mineral reserves that are supported by a technical report and completing a feasibility study. Section 4.2(6) of 43-101CP states, in part:

> "Historically, such projects have a much higher risk of economic or technical failure. To avoid making misleading disclosure, the issuer should disclose that it is not basing its production decision on a feasibility study of mineral reserves demonstrating economic and technical viability and should provide adequate disclosure of the increased uncertainty and the specific economic and technical risks of failure associated with its production decision."

Issue 1: Is it necessary for an entity to establish mineral reserves in order to demonstrate the technical feasibility and commercial viability of extracting a mineral resource under IFRS 6?

View 1A – Establishing mineral reserves is necessary to demonstrate technical feasibility and commercial viability.

Under this view, the term "economic viability" that is included in the CIM Best Practice Guideline (which makes reference to the requirements in NI 43-101) and "commercial viability" in IFRS 6 are considered to have a common meaning.

Proponents of this view note that reporting entities with mineral projects should provide their investors and other stakeholders with financial and technical information that is based on consistent concepts and terminology. Readers of financial statements will be confused if an entity's accounting policy describes demonstration of technical feasibility and commercial viability in a manner that conflicts with other disclosure provided in compliance with applicable securities legislation.

View 1B – Establishing mineral reserves is not required to demonstrate technical feasibility and commercial viability.

Proponents of this view note that in the absence of specific guidance under IFRS 6, management must use its judgment to determine how the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

Management may conclude that other factors demonstrate technical feasibility and commercial viability (for example, proximity of the area to a successfully developed and producing mine, results from a preliminary feasibility study or internal management analysis).

The Group's Discussion

A substantial majority of the Group members supported the view that the establishment of mineral reserves is not required to demonstrate technical feasibility and commercial viability (View 1B) for various reasons, including that IFRS 6 does not refer to mineral reserves. Group members observed that this is a complex area and IFRS 6 does not prescribe the specific nature of evidence required to establish technical feasibility and commercial viability.

One Group member noted that there would be commonality between IFRS 6 and the securities legislation requirements in the vast majority of circumstances but it would not be appropriate to

conclude this will always be the case. For example, there could be a situation when a feasibility study is obtained to establish mineral reserves but management encounters a permit issue that may preclude the development of a mine. Management may conclude that in such a situation, technical feasibility and commercial viability under IFRS 6 are not demonstrated despite the existence of an NI 43-101 report.

Another Group member noted that a feasibility study is important evidence but there can be technical or other reasons as to why a mineral property could be developed without this level of evidence. For example, when expanding an ore body in a project that is already underway, performing a feasibility study may damage the integrity of the ore body. In such a circumstance, there can be other evidence that is persuasive to support that the issuer has reached technical feasibility and commercial viability without establishing mineral reserves.

Two Group members leaned towards View 1A, taking more of an investor point of view that there needs to be enough high quality evidence to demonstrate that technical feasibility and commercial viability have been reached. However, another Group member noted that View 1A implies that an entity cannot demonstrate technical feasibility and commercial viability if it does not have an NI 43-101 report, and thinks reaching such a conclusion would be inappropriate without considering other factors.

A representative from the Canadian Securities Administrators (CSA) explained that they support View 1A noting that the provisions in NI 43-101 are based on internationally supported definitions. The CSA representative asked the Group for further details about the other factors that would be considered under View 1B when mineral reserves have not been established, and what disclosure solutions may be appropriate given the requirements in NI 43-101.

One Group member noted that IAS 1 *Presentation of Financial Statements* would require disclosures about the significant judgments applied by management, particularly when an issuer concludes that technical feasibility and commercial viability have been achieved without establishing mineral reserves. Another Group member noted that the appropriate warnings required by section 4.2(6) of Companion Policy 43-101CP still need to be disclosed in an entity's Management Discussion and Analysis to signal to users that the evidence obtained in reaching such a conclusion is different between what is required by the accounting requirements and the securities law.

Another Group member noted that other factors could include proximity to a successful mine as well as results from a preliminary feasibility study or internal management analysis. In some cases, management may decide there is sufficient evidence to develop the mine and that spending money to obtain a feasibility study is unnecessary.

Issue 2: If View 1A was accepted and management decides to develop a property without establishing mineral reserves, is it appropriate to capitalize expenditures related to the development of the mineral property?

According to paragraph 10 of IFRS 6, the *Framework* and IAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development.

Paragraph 21 of IAS 38 states:

> "An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably."

Paragraph 7 of IAS 16 *Property, Plant and Equipment* also notes that part of the criteria for recognizing a cost as an asset is that "it is probable that future economic benefit associated with the item will flow to the entity."

View 2A – No, without establishing mineral reserves, it would not be appropriate to conclude that it is probable that future economic benefits associated with a property under development will flow to the entity.

Proponents of this view note that the phrase "reasonable prospects for eventual economic extraction" from the CIM definition of mineral resource does not align with the IFRS concept of "probable that future economic benefits will flow to the entity." Instead, the concept of "economic viability" from the CIM definition of mineral reserve is more closely aligned with the IFRS concept of probable future economic benefits.

View 2B – Yes, management can use judgment and consider factors other than establishing mineral reserves to support a conclusion that it is probable that future economic benefits associated with a property under development will flow to the entity.

Proponents of this view note that management may base its conclusion on factors such as establishing mineral resources and those mentioned under View 1B.

The Group's Discussion

Group members views were generally aligned between the two issues (i.e., Group members who supported View 1B also supported View 2B).

A CSA representative asked the Group whether establishing technical feasibility and commercial viability without a pre-feasibility or feasibility study would be rare in practice.

Some Group members noted that in practice this circumstance would be fairly rare. However, one Group member commented hearing anecdotally from industry specialists that this situation could occur 5 to 10 per cent of the time and some others have provided estimates as high as 25 per cent. This Group member also noted that there are certain types of mining (for example, some forms of uranium mining) that never establish NI 43-101 mineral reserves. These mining entities generally are able to conclude based on persuasive evidence that they have reached technical feasibility and commercial viability and may profitably operate for years without having established mineral reserves under the requirements of NI 43-101.

Another observation made was that in some situations it could be less expensive to mine over the next twelve months when compared with the costs of obtaining a report under the requirements of NI 43-101. In such situations, it would be counterintuitive to obtain a study from an economic perspective.

In summary, Group members observed there is no bright line or evidentiary threshold specified in IFRS 6 requiring the establishment of mineral reserves in demonstrating technical feasibility and commercial viability. Although there is tension between IFRS 6 and NI 43-101, it is unclear how often there would be differences. However, there could be some industries, such as uranium, in which these differences are more common. Other circumstances, particularly for junior mining entities, may arise when the issuer may choose not to obtain a pre-feasibility or feasibility study because doing so would be cost prohibitive. In such situations, other persuasive evidence would be needed to support management's judgment in demonstrating technical feasibility and commercial viability.

One Group member noted that once an issuer concludes that technical feasibility and commercial viability are met, more rigorous impairment testing is required. Although not the issue being discussed, the CSA representative agreed that it is also a concern if an issuer remains in IFRS 6 for too long.

The CSA representatives will take the feedback received from the Group and consider what next steps may be needed. No further action was recommended to the AcSB.

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

IFRS 5: Abandonment or Sale of a Mineral Property

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires that entities present separately the post-tax income (or loss) of discontinued operations, including the post-tax gain or loss on disposal, in the statement of comprehensive income. IFRS 5 also requires disclosure of the net cash flows attributable to the discontinued operations.

Entities in the mining industry frequently decide that mineral properties do not warrant further exploration and evaluation work and will abandon their rights to the properties. Alternatively, the entities may sell their rights to the mineral properties rather than undertake further development.

Fact Pattern 1

A reporting entity's (the "Parent Entity") operations consist of the exploration for and evaluation of mineral property interests. The Parent Entity's mineral property portfolio consists of interests located in two countries – Country A and Country B. The mineral properties are held by a subsidiary in each of the two countries – Subsidiary A and Subsidiary B. Each subsidiary has a local manager and staff that are responsible for executing the work plan prepared by the senior management of the Parent Entity. In addition, the staff works with local officials to ensure compliance with applicable laws and regulations and ensure the rights to the mineral properties are maintained. The subsidiaries do not act autonomously and the senior management of the Parent Entity makes all investing and financing decisions. All financing is arranged by the Parent Entity and advanced to the subsidiaries by way of intercompany loans.

During the reporting period, the Parent Entity's senior management decided to focus its exploration and evaluation work on the mineral properties located in Country A. The decision was due to the fact that the mineral properties in Country A showed more promising results and were attracting more interest from investors. Subsidiary B was therefore sold to a third party resulting in a loss on disposal. As a result of the disposal, the group has no further activity in Country B.

Issue 1: Does the sale (or abandonment) of a subsidiary that holds mineral resource interests require presentation as a discontinued operation?

View 1A – The disposal of Subsidiary B should be presented as a discontinued operation.

Under this view, Subsidiary B is considered a "component" as defined by IFRS 5.

Proponents of this view note that Subsidiary B likely represents a separate geographical area of operations given that Subsidiary B had its own manager and employees that were responsible for carrying out the exploration work on mineral properties located in Country B. Further, the mineral properties of Subsidiary B were independent of the assets and operations of Subsidiary A. The exploration work on Subsidiary B's mineral properties resulted in operations and cash flows that can be distinguished from Subsidiary A and the assets were sold to a third party without affecting the other assets of the group.

View 1B – The disposal of Subsidiary B should not be presented as a discontinued operation.

Under this view, Subsidiary B cannot be considered a "component" as defined by IFRS 5.

Paragraph 31 of IFRS 5 indicates that "a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use." Given that Subsidiary B was dependent on the Parent Entity for financing and it was not generating revenues of its own, it likely does not satisfy the definition of a cash-generating unit. Further, the involvement of the senior management of the Parent Entity in all of its strategic decisions prevents it from being clearly distinguishable from the rest of the group, both from an operational and financial reporting perspective.

The Group's Discussion

A question was raised as to whether the fact pattern would be considered an abandonment of a mineral property or held for sale. The fact pattern was clarified to note that Subsidiary B was sold to a third party for nominal value rather than to generate cash flow. One Group member noted that although a sale or abandonment of a mineral property may qualify as a discontinued operation depending on the facts and circumstances, there may be a difference as to the timing of when a discontinued operation presentation can occur. The presentation of discontinued operations only starts in the period when the abandonment actually occurs. However, when assets are being sold, a discontinued operation presentation would occur when the criteria to be classified as held for sale are met.

One Group member questioned whether Subsidiaries A and B would be separate operating segments. A few Group members noted that if the subsidiaries were separate operating segments, presenting the disposal of Subsidiary B as a discontinued operation would be appropriate (View 1A). However, if the subsidiaries were not separate operating segments, then it would not be appropriate to present the disposal of Subsidiary B as a discontinued operation (View 1B). Further, Group members indicated that if there is only one cash-generating unit, it would be difficult to support presentation as a discontinued operation.

One Group member would not preclude View 1A because the added disclosure may have value to users of the financial statements. However, another Group member observed that for junior exploration entities, the additional disclosure may not be particularly useful.

One Group member observed that IFRS 5 includes the notion of an operation that is not necessarily a business. In this fact pattern, there appears to be some form of operation (for example, employees conducting activities) even though the entity is in the exploration and evaluation phase. As a result, there may be room for judgment to be applied to describe what that operation is in the context of this fact pattern. However, another Group member thought that an operation implied more than carrying out an exploration program, but having revenue and outputs as well.

Fact Pattern 2

An entity intends to dispose of a subsidiary after the reporting period end date. The IFRS 5 criteria for classifying as held for sale were met and therefore the subsidiary was classified as such in the entity's consolidated financial statements. It is expected that the proceeds that will be received on the disposal of the subsidiary (which comprises the disposal group) will be at least as much as the carrying value of the net assets of the disposal group plus any disposal costs such that no impairment was recognized. Prior to the reporting period end date, the entity incurred incremental costs relating to the planned disposal of the subsidiary.

Issue 2: What is the appropriate accounting treatment of disposal costs incurred prior to the reporting period end date when the disposal is completed after the reporting period end date?

View 2A – The disposal costs incurred prior to the reporting period end date should be capitalized.

Under this view, the entity is incurring the costs that are related to the planned disposal on the basis that it anticipates that these costs will result in its ability to recover the carrying value of the disposal group plus the disposal costs incurred or to be incurred. As the fair value of the disposal group less costs to sell is higher than the carrying value of the asset, the disposal costs incurred prior to the disposal provide a future benefit to the entity.

View 2B – The disposal costs incurred prior to the reporting period end date should be expensed.

Under this view, incurring costs that are incremental to the planned disposal of a subsidiary does not result in an identifiable asset that should be capitalized. While the costs do relate to an activity that could be viewed as resulting in a future economic benefit to the entity, the criteria for asset recognition are not met. The costs are more appropriately reflected as an expense relating to the period in which the costs were incurred.

View 2C – The disposal costs incurred prior to the reporting period end date should either be expensed or capitalized depending on the nature of the expense.

Under this view, certain costs may be capitalized if incurred to facilitate a sale of the assets to a third party in a manner that will maximize potential proceeds. For example, the entity may incur costs to add to the original service potential of the underlying assets and, therefore, attract more potential buyers or result in a higher price. Other costs, such as selling costs, would normally be expensed because they do not create an identifiable asset.

The Group's Discussion

Group members supported that the disposal costs incurred prior to the reporting period end date should be expensed (View 2B), finding no basis to support deferring such costs.

Some Group members questioned whether the held for sale criteria were met in this fact pattern if the entity is still adding value or incurring costs that would enhance the service potential of the asset. The asset needs to be available for sale in its present condition in order to satisfy the held for sale criteria in IFRS 5.

One Group member noted that if there is an impairment, rather than an anticipated gain on disposal, the treatment of disposal costs is consistent with View 2B. Such costs are not accrued in advance of being incurred but rather IAS 36 requires that the costs to sell to be factored into the determination of the recoverable amount and resulting impairment. Another member noted that the timing of expensing the selling costs can pose interesting questions. For example, if an entity hires an advisor with fees contingent on the successful sale, the contract is an executory arrangement but the trigger for expense recognition is the completion of a successful sale. However, for other types of non-contingent fee arrangements such as hourly fees paid to lawyers or other advisors, amounts are expensed as services are provided to the entity.

The Group recommended that the AcSB consider whether any actions should be taken on the first issue. Such actions could include connecting with CPA Canada's Mining Industry Task Force on IFRSs to raise awareness of the discussions around the meaning of operation and the interaction with the requirements of IFRS 8 *Operating Segments*. No further action was recommended to the AcSB on the second issue.

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

IFRS 11: Interests of "Other Parties" to a Joint Operation

Paragraph 23 of IFRS 11 *Joint Arrangements* states that "other parties" to a joint operation account for their interests in the same way as a joint operator if they have rights to the assets and obligations for the liabilities:

> "A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 20–22 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the IFRSs applicable to that interest."

Paragraph BC49 in the Basis for Conclusions to IFRS 11 states:

> "In relation to parties that participate in, but do not have joint control of, a joint arrangement that is a joint operation, the Board focused its discussions on those parties for which the contractual arrangements specify that they have rights to the assets, and obligations for the liabilities, relating to the joint operation. The Board concluded that, even though those parties are not joint operators, they do have rights and obligations for the assets, liabilities, revenues and expenses relating to the

joint operation, which they should recognise in accordance with the terms of the contractual arrangement."

Fact Pattern

Parties A, B and C enter into an arrangement in which Parties A and B share joint control while Party C has only significant influence. The arrangement is structured through a separate vehicle. The three parties hold ordinary shares issued by the vehicle.

Parties A, B, and C have an obligation to purchase all the output from the vehicle and to fund the vehicle in proportion to their interests. The only difference between Parties A and B, and Party C is the percentage of interest (lesser for Party C compared to Parties A and B) and the fact that Party C does not share joint control.

The vehicle qualifies as a joint operation as a result of the "other facts and circumstances" test in paragraphs B29 to B32 of IFRS 11.

Issue: Should paragraph 23 of IFRS 11 only be applied by a party to a joint operation that did not apply the "other facts and circumstances" test?

View A – No.

Proponents of this view note that a party to a joint operation should apply the "other facts and circumstances test" in determining the accounting for its interest in the joint arrangement. Therefore, in the fact pattern presented, line-by-line accounting is applied such that the party accounts for its share of assets, liabilities, revenues and expenses.

IFRS 11 is based on accounting for a party's rights and obligations regardless of whether there is joint control or not. The standard uses the term "parties" and not just joint controllers, and hence applies to "other parties".

Paragraphs B29 to B32 of IFRS 11 explain how the parties' off-take rights and obligations are in substance economic rights to individual assets and obligations for individual liabilities when the activities of an arrangement are primarily designed for the provision of output to the parties. Hence, the line-by-line accounting is not dependent on the parties having joint control of the vehicle but rather because of the off-take rights and obligations.

View B – Yes.

Under this view, the equity method of accounting is applied because Party C holds an equity interest in the vehicle and has significant influence. Therefore, IAS 28 *Investments in Associates and Joint Ventures* would apply. Without significant influence, IAS 39 *Financial Instruments: Recognition and Measurement* would apply. There is no scope exemption in IAS 28 or IAS 39 for this situation.

Proponents of this view note that it is difficult to support that the "other party" has "in substance" or "indirect" rights to the assets and obligations for the liabilities, without having the power associated with joint control.

The Group's Discussion

Group members agreed that View A was more appropriate, and that an "other party" to a joint operation should also apply the other facts and circumstances test in determining the accounting for its interest in the joint arrangement. One Group member noted that the other facts and circumstances test in IFRS 11 applies to all parties to a joint operation, and not only to joint controllers. Furthermore, the requirement to recognize the assets that a party is economically entitled to, and the liabilities that it is obligated for, equally applies to all parties to a joint operation. Several other members agreed that the requirements in paragraph 23 of IFRS 11 were clear in this regard.

Group members discussed the scenario when there is no longer joint control because one of the former joint operators subsequently takes control of the arrangement. Group members agreed that once the arrangement is no longer a joint operation, these new facts and circumstances must be considered by Party C in determining the appropriate accounting. Group members noted that Party C only owns shares, and the only circumstances under which equity accounting can be overridden is in the context of IFRS 11, and the other facts and circumstances test. The requirements of IFRS 11 would no longer apply in the absence of joint control. One Group member observed that he had seen similar fact patterns, specifically for loss of control transactions, and at that time the view was that equity accounting would be required.

Several Group members expressed a concern that conceptually it seems counterintuitive that Party C would be forced to change its accounting in this scenario when the arrangement is no longer a joint operation. Group members noted that little had changed with respect to Party C's interest and they do not understand why a change in the ownership interests of other parties to the former joint operation should be relevant to Party C's accounting.

Group members agreed that the effect on Party C's accounting under this scenario may represent an inherent flaw in IFRS 11, and recommended that this issue be added to a list of concerns with the standard to be raised by the AcSB when a post-implementation review of IFRS 11 is conducted.

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

IAS 32: "Fixed-for-fixed" Condition

Paragraph 15 of IAS 32 *Financial Instruments: Presentation* states:

> "The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument."

The definitions of financial assets, financial liabilities and equity instruments are contained in paragraph 11 of IAS 32.

Paragraph 16 of IAS 32 provides the conditions that must be met for a financial instrument to be classified as an equity instrument instead of a financial liability. Paragraph 16(b)(ii) of IAS 32 is referred to as the "fixed-for-fixed" condition. This paragraphs states, in part, that "if the instrument will or may be settled in the issuer's own equity instruments, it is a derivative that will be settled only by the issuer

exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments."

Challenges may arise in interpreting the fixed-for-fixed condition because IAS 32 contains limited guidance on this condition.

The IFRS Interpretations Committee discussed the fixed-for-fixed condition at its November 2009 meeting and issued an agenda decision in January 2010. It noted that there may be diversity in practice with respect to the application of the condition but decided not to add the topic to its agenda because the IASB's *Financial Instruments with Characteristics of Equity* project was expected to address issues on a timely basis. However, this project has since been deferred and is now included in the IASB's research program.

Fact Patterns

The following facts apply to the five fact patterns below:

- Besides the specific term or clause discussed, the instrument would otherwise meet the fixed-for-fixed condition.
- The instruments are all denominated in the issuer's functional currency.

Fact Pattern 1

A share purchase option is exercisable at $0.05 per share for the first year after issue and $0.10 in the second and third year after issue before expiring at the end of year 3.

Issue 1: Is the fixed-for-fixed condition met when the exercise price is pre-determined at inception and only varies over time?

Yes, the only variable affecting the exercise price is time (i.e., when the holder exercises the share option). At any point in time, the exercise price for immediate exercise is known. Hence, the terms of the contract do not introduce variability that is unknown at the inception of the contract.

The Group's Discussion

Group members agreed that the fixed-for-fixed condition is met for this fact pattern for the reasons noted above.

Fact Pattern 2

A share purchase option is exercisable at $1 per share for one common share.

The share option agreement provides for an adjustment to the exercise price or the number of shares under the option in the event of a consolidation, special dividend, bonus issue or rights issue to all existing common shareholders. For example, if there were a two-for-one stock split, the option exercise price would be changed to $0.50 per common share.

The adjustment retains the relative rights of the existing shareholders and the option holders by preventing the option holder's interests from being diluted.

Issue 2: Is the fixed-for-fixed condition met when the relative rights of the shareholders and option holders are maintained on an equal footing?

Yes, when a fixed number of shares will or may be delivered for a fixed amount of cash, the holder of the instrument is exposed to changes in the fair value of the shares under the share option as if he or she already holds the underlying shares. Thus, the risks and rewards that the instrument holder is exposed to are similar to a shareholder.

The adjustment aligns the risks and rewards of the option holders with those of the shareholders. The variability that is introduced with each of the conditions ensures that the option holders remain exposed to the same fair value changes as the ordinary shareholders. The option holders are given the same benefit or are put in the same position as the shareholders such that their relative rights are maintained.

The Group's Discussion

Group members agreed that the fixed-for-fixed condition is met for this fact pattern for the reasons noted above.

Fact Pattern 3

A share purchase option is exercisable at $1 per share.

The share option agreement provides for a reduction to the exercise price (or increase in the number of shares delivered under the option) in the event that shares are issued below $1 per share. Such a clause is often referred to as a "down-round" or "price-protection" clause.

The intention of the adjustment clause is to protect the option holders from adverse movements in the share price. The existing shareholders do not receive a similar benefit.

Issue 3: Is the fixed-for-fixed condition met when the option holders receive protection from reductions in the share price that shareholders do not?

No, the fixed-for-fixed condition cannot be considered met when the relative rights of the shareholders and option holders are not maintained on equal footing. The down-round clause only protects the option holders from adverse movements in the share price at the expense of the existing ordinary shareholders. This adjustment clause has the potential to transfer value (in relative terms) from the existing ordinary shareholders to the option holders.

The Group's Discussion

Group members agreed that the fixed-for-fixed condition is not met for this fact pattern for the reasons noted above.

Fact Pattern 4

A share purchase option is exercisable at $1 per share. The option is exercisable by the holder only upon the occurrence of a contingent event that is outside the control of the holder and the issuer. For example, the option is mandatorily exercisable by the holder when the share price is above a certain dollar value and remains above that dollar value for a certain period of time.

Issue 4: Is the fixed-for-fixed condition met when the conversion of the instrument is based on a contingent event?

View 4A – The fixed-for-fixed condition is met.

Assuming the contingent event occurs or if the contingency is ignored, proponents of this view note that the amount of shares delivered and the amount of cash received upon exercise are both fixed. Thus, the contingency affects the value of the share option and probability of exercise, not whether the fixed-for-fixed condition is met.

View 4B – The fixed-for-fixed condition is not met.

Proponents of this view note that the contingency is financial in nature. The contingency limits the option holder's exposure to fair value increases in the share option. The ordinary shareholders and option holders are not exposed to the same relative fair value changes in the share price.

The Group's Discussion

Group members agreed that the fixed-for-fixed condition is met (View 4A) for this fact pattern.

One Group member noted that the contingency aspect is irrelevant and the limit on the variability that the option holder is exposed to is not an important point of consideration. Another Group member noted that what is relevant is when the contingency does occur, the option holder has the right to exercise a fixed number of shares for a fixed price. As a result, the fixed-for-fixed condition is met for this fact pattern.

Fact Pattern 5

A share purchase option is exercisable at a price determined as follows:

- In the event of a 1:5 share consolidation occurring before the end of Year 1, the share option will be exercisable at $0.10 per share until expiring at the end of Year 3.
- In the event of a share consolidation not occurring before the end of Year 1, the share option is exercisable at $0.05 per share in Year 2 and $0.10 per share in the third year before expiring at the end of Year 3.
- The option is not exercisable until a share consolidation has taken place or one year has passed since issuance.

The issuer intended to set the exercise price at $0.02 but the stock exchange has a minimum pricing requirement of $0.05 per share. Therefore, the terms provide an incentive for the issuer to effect a share consolidation so that the exercise price can be above the minimum pricing requirement of the stock exchange ($0.02 x 5 = $0.10 price with share consolidation).

The share consolidation is subject to approval by the directors, shareholders and stock exchange but has been initiated by the issuer at the time of issuing the instruments. The consolidation is considered highly likely but will take between six and twelve months to complete.

Issue 5: Is the fixed-for-fixed condition met when a share consolidation is a contingent event?

View 5A – The fixed-for-fixed condition is met.

Under this view, the share consolidation does not affect whether the fixed-for-fixed condition is met but rather the likelihood that one of the two options is exercised. The option contract issued can be viewed as two independent contingent options with a fixed amount of cash being exchanged for a fixed amount of equity instruments if certain contingent events arise. The exercise price in each option is pre-determined at inception and only varies over time.

View 5B – The fixed-for-fixed condition is not met.

Under this view, the condition is not met because the amount of cash that is exchanged can vary depending on whether a share consolidation has occurred at the exercise date (i.e., either one share can be issued for $0.05 or one share can be issued for $0.10 such that the amount of cash for the overall contract varies). Additionally, the exercise price varies not just over time but also depends on the outcome of a contingent event. The contingent event is not completely outside the control of the issuer because it is initiated by the entity and approved by the shareholders.

The Group's Discussion

One Group member raised a question regarding how "the terms provide an incentive for the issuer to effect a share consolidation so that the exercise price can be above the minimum pricing requirement of the stock exchange." The Group member noted that if there is no share consolidation, there will be less dilution, and if there is a share consolidation, there would be more incentive for the option holder of the instrument to exercise. It was noted that this sentence could be removed from the fact pattern and it would not affect the outcome. Implicit in the fact pattern is that the shareholders want the exercise price proceeds for a source of capital.

Group members supported the view that the fixed-for-fixed condition is not met (View 5B) and observed that the further an instrument diverges from a plain vanilla fixed-for-fixed option, the more difficult it is to support meeting the fixed-for-fixed condition.

Group members considered whether an argument could be made that the share consolidation does not have substance because the likelihood of the share consolidation not occurring is low and it is outside the control of the option holder or issuer. Group members thought that to support this argument, the "not genuine" condition in IAS 32 would need to be invoked. Group members were reluctant to apply such a condition, noting that any potentially non-genuine clauses would generally be removed from an agreement before being signed. If one or both of the parties do not agree with its removal, this is evidence that the term is in fact genuine. The share consolidation is critical to the economics in this fact pattern and the time it takes to effect the share consolidation suggests there is some element of uncertainty.

Group members also considered whether viewing the instrument as two separate options could support equity classification. If the instrument is viewed as two separate options, both the time-based element and contingency element might meet the fixed-for-fixed condition separately. However, Group members noted that the arrangement should be looked at in totality because of the interdependency of

the outcomes. In this fact pattern, the outcomes are interdependent because there is only one outcome that could occur. As a result, the unit of account is the arrangement as a whole and Group members agreed that the fixed-for-fixed condition is not met for this fact pattern.

It was also noted that the IFRS Interpretations Committee considered a few issues relating to IAS 32 in 2014.[5] The IFRS Interpretations Committee considered a series of issues concerning whether an instrument convertible to a variable number of shares, subject to a cap and floor, can be bifurcated. The IFRS Interpretations Committee concluded that as the instrument has one outcome; it cannot be bifurcated.

In summary, Group members agreed that the fixed-for-fixed condition is met for Fact Patterns 1, 2 and 4 and that the fixed-for-fixed condition is not met for Fact Patterns 3 and 5. Group members observed that an underlying conceptual principle for applying the fixed-for-fixed condition is that the option holder is exposed to both the upside and downside of an arrangement (i.e., fluctuations above or below the fixed price). As a result, equity classification is appropriate if the option holder is put in the same position as an equity instrument holder. In contrast, if the option holder has a variable number of shares, he or she is often protected from such fluctuations.

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

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

IFRS 3 and IAS 39: Transaction Price Allocation

IFRS 3 *Business Combinations* provides specific guidance on how to allocate the cost of acquisition when an entity acquires a group of assets that does not constitute a business. Paragraph 2(b) of IFRS 3 indicates that the cost of acquisition should be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of acquisition.

However, a potential conflict arises when the group of assets acquired include financial instruments. Paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement* generally requires an entity to measure individual financial instruments at fair value. Paragraphs AG64 and AG76 of IAS 39 also provide guidance on whether the difference between the transaction price and the fair value of the individual financial instruments at the date of acquisition should be recognized as an immediate gain or loss.

Fact Pattern

An entity acquires a group of assets, including both financial instruments and non-financial items, which do not meet the definition of a business under IFRS 3. While the transaction price represents the fair

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[5] For example, the IFRS Interpretations Committee considered how an issuer would account for a particular mandatorily convertible financial instrument. The IFRS Interpretations Committee's May 2014 agenda decision stated that "[s]uch a single obligation to deliver a variable number of own equity instruments cannot be subdivided into components for the purposes of evaluating whether the instrument contains a component that meets the definition of equity. Even though the number of equity instruments to be delivered is limited and guaranteed by the cap and the floor, the overall number of equity instruments that the issuer is obliged to deliver is not fixed and therefore the entire obligation meets the definition of a financial liability."

value of the group of assets, there is a difference between the sum of the fair values of the net identifiable assets acquired and consideration paid. The entity has assessed that there are no other identifiable assets or liabilities causing the difference.

Issue: How should the total cost of purchase be allocated to individual assets and liabilities when the group of assets acquired is not a business and includes both financial instruments and non-financial items?

View A – IFRS 3 and IAS 39 both apply.

Under this view, the entity should first follow IFRS 3 to allocate the acquisition price to each of the identifiable assets and liabilities in the bundle based on relative fair value and then apply paragraph AG76 of IAS 39 to determine the fair value of each individual financial instrument. To the extent that a difference exists, a day one gain or loss should be recognized if the fair value of the financial instrument meets the observability conditions in paragraph AG76(a) of IAS 39.

Proponents of this view note that there are no initial measurement scope exceptions in IAS 39 for financial instruments recognized in a bundled purchase.

View B – IAS 39 takes precedence.

Proponents of this view note that IAS 39 takes precedence over IFRS 3 because it is the more specific standard that pertains to the initial recognition and measurement of a financial asset or liability. Further, there is no scope exclusion in IAS 39 for the initial measurement of financial assets or liabilities acquired as part of a bundle.

There are three views under View B on how to apply IAS 39 first.

View B1 – Measure those financial instruments whose fair value meets the observability conditions at fair value.

Under this view, the entity should first measure only the financial instruments that have an observable fair value at that fair value and then allocate the residual to the remaining identifiable assets based on relative fair value. This approach results in no day one gain or loss recognition.

View B2 – Measure those financial instruments subsequently measured at fair value.

Under this view, the entity should first measure those financial instruments that will be subsequently measured at fair value and then allocate the residual to the remaining identifiable assets based on relative fair value, including financial instruments recognized at amortized cost. The catch-up recognition of any day one gains or losses is avoided through subsequent measurement at fair value. However, if a residual value is allocated to a financial instrument not subsequently measured at fair value (for example, a debt instrument held at amortized cost) that meets the observability condition in paragraph AG76 of IAS 39, a day one gain or loss would be recognized.

View B3 – Measure all financial instruments at fair value.

Under this view, the entity should first measure all financial instruments at fair value and then allocate the residual to the remaining identifiable non-financial assets based on relative fair value. This approach results in no day one gain or loss recognition.

View C – IFRS 3 takes precedence.

Under this view, the entity should allocate the acquisition price based on a relative fair value basis with no application of the initial measurement requirements of IAS 39. The entity would apply the subsequent measurement guidance in IAS 39, and any financial instruments that are classified at fair value through profit or loss, or available for sale, would be remeasured on day two, resulting in a gain or loss recognized through profit or loss, or other comprehensive income.

Proponents of this view note that IFRS 3 specifically deals with the purchase of a group of assets. In contrast, IAS 39 does not specifically address the acquisition of financial instruments as part of a bundle.

View D – Different views may be appropriate depending on facts and circumstances.

Proponents of this view note that absent any specific guidance over which standard takes precedence, different interpretations are possible and may depend on the specific facts and circumstances.

The Group's Discussion

Some Group members observed that paragraph 2(b) in IFRS 3 is problematic as guidance on the acquisition of an asset (or group of assets) that does not constitute a business is included in the scoping paragraph. This paragraph states the following:

> IFRS 3 does not apply to "the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in IAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill."

Most Group members supported the idea that IAS 39 takes precedence over IFRS 3, and the view that financial instruments are accounted for at fair value and any residual is allocated to the remaining identifiable non-financial assets based on the relative fair value (View B3). Group members thought that this view is most defensible because it does not create any day one gains or losses and it is the common approach seen in practice.

A few Group members thought it would be difficult to rule out Views A and B1 in the absence of specific guidance that addresses the fact pattern. However, one Group member indicated that it would be difficult to support View A because it would lead to a day one gain or loss when there is no objective evidence that one has occurred.

Most Group members ruled out the approach of fair valuing those financial instruments subsequently measured at fair value and allocating the residual to the remaining identifiable assets based on relative fair values (View B2), and allocating the acquisition price on a relative fair value basis with no application of the initial measurement requirements of IAS 39 (View C). Group members indicated that both these views are difficult to support.

Some Group members also could support that determining whether IFRS 3 or IAS 39 takes precedence in allocating the transaction price depends on an entity's individual facts and circumstances (View D).

One Group member highlighted that the motives of the relevant parties in a transaction can have a significant effect on the negotiated transaction price, which may not be indicative of the fair value of the underlying net assets of a transaction. For example, if a seller is motivated to sell a portfolio of financial instruments to meet certain regulatory requirements, the seller may negotiate a price that is lower than the fair value to expedite the transaction.

An additional consideration regarding the treatment of transaction costs was also discussed. Group members supported the view that it is reasonable to first allocate the acquisition price, excluding transaction costs, and then allocate transaction costs based on the relevant guidance of other standards.

Group members observed that there was some support for four of the six views and guidance to eliminate this diversity would be helpful. As a result, the Group recommended that the issue be discussed with the AcSB to determine whether it should be raised to the IASB or IFRS Interpretations Committee.

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

IFRS 15: Guidance from the Transition Resource Group

The Transition Resource Group (TRG) for Revenue Recognition was initially established as a joint initiative between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). The purpose of the joint TRG was to:

- solicit, analyze and discuss stakeholder views arising from implementation of the new guidance;
- inform the IASB and FASB about implementation issues and determine what actions are needed to address those issues; and
- provide a forum for stakeholders to learn.

TRG papers and meeting summaries are publicly available and include statements along the following lines:

> "TRG members agreed that a reasonable application of either View A or View B should result in similar financial reporting outcomes and that reasonable application of either view could be accomplished with processes and internal controls to identify payments to customers that could be related to a revenue contract. No TRG member agreed with View C."[6]

Questions have arisen from preparers regarding the relevance of discussions of the TRG in preparing financial statements in accordance with IFRSs. Regulators in Europe and the U.S. have made certain public statements regarding the relevance of TRG discussions.

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[6] Extract from paragraph 11 of the July 2015 Joint IASB/FASB TRG meeting summary.

Issue 1: What is the relevance of the Joint IASB/ FASB TRG material to Canadian entities applying IFRSs?

View 1A – TRG material is non-authoritative.

Proponents of this view note the following:

- TRG material is not included in the definition of IFRSs in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- The Operating Procedures of the TRG explicitly states: "the TRG will not issue guidance." The IFRS Foundation Trustees' Due Process Oversight Committee has made a similar statement.
- The headnote to the TRG staff papers and meeting summaries note, "comments on the application of U.S. GAAP or IFRS do not purport to set out acceptable or unacceptable application of U.S. GAAP or IFRS."
- Regulators have also noted that the TRG does not provide authoritative guidance.

View 1B – Preparers should consider TRG material.

While proponents of this view acknowledge that TRG material is not authoritative, they note that the meeting discussions generally represent a consensus of views of the participants. In many cases, the majority or all of the participants agreed on a particular view.

Proponents of this view also note that regulators in certain jurisdictions, such as the U.S. Securities and Exchange Commission (SEC) and the European Securities and Markets Authority, have made comments that indicate they are either expecting or encouraging preparers to consider TRG views.

Issue 2: What is the relevance of the FASB TRG material to Canadian entities applying IFRSs?

In January 2016, the IASB announced that it does not plan to schedule further meetings of the IFRS constituents of the TRG. However, the IASB will continue to collaborate with the FASB and monitor any future discussions of the FASB TRG.

View 2A – FASB TRG material is not required to be considered.

Proponents of this view note that the IASB indicated "companies reporting using IFRS Standards are not required to consider the pronouncements or public discussions of the FASB in applying IFRS Standards."[7] The European Securities and Markets Authority has also cautioned against considering the FASB clarifications.

Paragraph 12 of IAS 8 also states:

> "In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11."

[7] IASB completes decision-taking on clarifications to its Revenue Standard (January 21, 2016 Press Release).

View 2B – FASB TRG material should be considered.

Proponents of this view note that the FASB TRG material should be considered when the guidance in U.S. GAAP is similar to IFRSs. Their rationale is that the standard was jointly developed and relatively few differences exist.

In addition, the SEC Chief Accountant commented: "the SEC staff will be informed by the TRG discussions when evaluating the reasonableness of registrant revenue recognition policies, whether established under U.S. GAAP or IFRS."[8]

View 2C – Canadian SEC Registrants[9] should consider the FASB TRG material.

Proponents of this view note that Canadian SEC registrants should consider TRG discussions in light of the SEC Chief Accountant's comments described under View 2B.

The Group's Discussion

Group members discussed both Issues 1 and 2 together.

The presenter clarified that View 1A should be rephrased to state that preparers are encouraged to use the TRG material. The way View 1A is stated implies that the alternative view would be the TRG material is authoritative, which is incorrect because the TRG material is clearly non-authoritative. View 1B is different, stating that preparers should consider the TRG material.

Group members noted that "consider" is a somewhat obtuse term because it puts the onus on preparers to understand the context of the joint TRG discussions and demonstrate that the material does not apply to their fact pattern. In terms of the FASB TRG material, Group members agreed that it is clear that Canadian SEC registrants need to follow the discussions because the SEC determines the accounting framework to be used to file continuous disclosure documents in the U.S.

An observation was made that Canadian IFRS financial statements will potentially be compared to the financial statements of Canadian foreign private issuers that follow the FASB TRG discussions given the SEC's position. As a result, preparers should be cognizant about Canada's marketplace when evaluating whether to consider the FASB TRG material. However, a few Group members thought that it would not be appropriate for Canadian entities not listed in the U.S. to be held to a different standard than entities in other jurisdictions.

A representative from the Canadian Securities Administrators (CSA) noted that if a fact pattern discussed by the joint TRG was similar to an issuer's facts and circumstances, the CSA would strongly encourage those discussions be considered in determining an appropriate accounting treatment. As for the FASB TRG material, the CSA representative indicated that there is nothing published by the FASB that is required to be followed by an issuer preparing financial statements in accordance with IFRSs.

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8 Remarks before the 12th Annual Life Sciences Accounting and Reporting Congress (March 22, 2016 speech).

9 The Group's discussion has not separately considered any difference between IFRS filers and U.S. GAAP filers with respect to the SEC.

However, the FASB TRG material represents a relevant body of literature that may help to inform an issuer's views if IFRSs did not provide a clear answer for a particular set of facts and circumstances.

The Group discussed various interpretations of paragraph 12 in IAS 8 in relation to the TRG guidance. There was some discussion around whether "other accounting literature" in this paragraph means only authoritative guidance. A CSA representative thought that this paragraph should be interpreted more broadly, and the FASB TRG material fits into paragraph 12 of IAS 8 as being part of "other accounting literature." One Group member noted that although large entities may look at multiple sources of guidance, smaller entities often lack the resources to do so and may not be knowledgeable about the discussions of the FASB TRG. The Group member was concerned that not considering the FASB TRG material may have implications for the internal control certifications.

Group members noted that the IASB has stated explicitly that the FASB TRG material does not need to be considered. Group members viewed this strong statement as a caution regarding the use of FASB TRG material because the discussions are based on U.S. perspectives. Some Group members noted that different answers could emerge in practice between SEC and non-SEC registrants. It was noted that the Group is in a unique position to identify issues in which divergent views are emerging between applying IFRS 15 *Revenue from Contracts with Customers* and FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers*. Raising these issues for discussion with the IFRS Interpretations Committee would be helpful in some cases, especially considering the IASB's focus on providing implementation guidance.

To alleviate some of the concerns expressed, the CSA representatives agreed to provide additional information on this topic at the Group's next meeting.

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

IAS 1: Use of Non-GAAP Financial Measures

Effective January 1, 2016, the clarifying amendments to IAS 1 *Presentation of Financial Statements* include additional guidance on the presentation of additional line items and subtotals in the financial statements, specifically the statements of profit or loss and financial position.

In addition, the Canadian Securities Administrators (CSA) issued Staff Notice 52-306 (Revised) "Non-GAAP Financial Measures" in January 2016, which states:

> "A non-GAAP financial measure is a numerical measure of an issuer's historical or future financial performance, financial position or cash flow that is not specified, defined or determined under the issuer's GAAP (as that term is defined in National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*) and is not presented in an issuer's financial statements."

Issue 1: Consider the clarifying amendments to IAS 1 and the implications (if any) on the presentation and disclosure of additional subtotals in the financial statements.

Paragraph 85A of IAS 1 states:

> "When an entity presents subtotals in accordance with paragraph 85, those subtotals shall:

(a) be comprised of line items made up of amounts recognised and measured in accordance with IFRS;

(b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;

(c) be consistent from period to period, in accordance with paragraph 45; and

(d) not be displayed with more prominence than the subtotals and totals required in IFRS for the statement(s) presenting profit or loss and other comprehensive income."

Furthermore, paragraph 85B of IAS 1 states:

> "An entity shall present the line items in the statement(s) presenting profit or loss and other comprehensive income that reconcile any subtotals presented in accordance with paragraph 85 with the subtotals or totals required in IFRS for such statement(s)."

Some commonly presented subtotals in the statement of profit or loss include:

- earnings before interest, tax, depreciation, and amortization (EBITDA); and
- operating income or result.

In addition, some entities present other subtotals such as "adjusted" earnings before interest, tax, depreciation and amortization, with specific adjustments made for amortization that relates solely to intangible assets and fair value adjustments for assets acquired in a business combination.

The Group's Discussion

The Group discussed five questions relating to Issue 1.

Question 1: Given the clarifications in IAS 1 and the updated CSA Staff Notice, are additional subtotals in the financial statements presented in accordance with IAS 1 considered non-GAAP?

A representative from the CSA agreed that additional subtotals presented in the financial statements in accordance with IAS 1 are outside the scope of the CSA Staff Notice because they do not meet the definition of non-GAAP measures.

Question 2: Is labelling a line item as "adjusted" in the financial statements sufficient to provide users with a clear understanding of the subtotal in accordance with paragraph 85A(b) of IAS 1? In other words, is an adjustment for a subset of amortization still considered to be a line item recognized and measured in accordance with IFRSs?

Group members considered the example of "adjusted EBITDA" resulting from a specific adjustment for amortization that relates solely to intangible assets and fair value adjustments for assets acquired in a business combination.

One Group member noted that IAS 1 contemplates computing a subtotal, rather than adjusting a line item. Some Group members observed that they struggle with this label, noting that it does not articulate what adjustments are made. Group members observed that using an "adjusted EBITDA"

label in the Management Discussion and Analysis (MD&A) is generally accepted but using such a label on the face of the financial statements is not done in practice.

A CSA representative noted that IAS 1 explicitly requires preparers to use a label that is clear, understandable, and reflective of the line items that constitute the subtotal. Using the word "adjusted" does not meet this requirement and is not within the spirit of the IAS 1 amendments. If this label is used in a financial statement, a concern would be raised that it did not comply with IAS 1.

Group members observed that the segment note disclosure may refer to "adjusted EBITDA" if the chief operating decision maker uses this measure to evaluate how management assesses its performance. In addition, this measure may also be referred to in the capital management note when quoting a debt covenant. Although Group members observed that using adjusted EBITDA may be appropriate in certain note disclosures, preparers are cautioned that this does not suggest the ability to use such measures in other areas of the financial statements.

Question 3: Is there a presentation format that would allow an entity with a "by function" statement of profit or loss to present additional subtotals?

Group members considered an example of an entity that uses a functional approach and includes an additional subtotal of earnings before stock-based compensation or restructuring expense. Group members were asked whether this presentation results in the statement of profit or loss no longer complying with paragraph 99 of IAS 1 because such expenses cross over multiple functions.

Group members observed that a mixed approach is acceptable on the face of the financial statements with detailed disclosure by nature provided in the notes to the financial statements. As a result, one Group member indicated that the entity may show restructuring expense as a separate line item on the face of the financial statements, even though it crosses different functions. Another Group member agreed but was more concerned with showing stock-based compensation as a separate line item because the nature of the expense could be allocated by function.

Question 4: Given the guidance in paragraph 85A(a) of IAS 1, to what extent could the presentation of additional subtotals be permissible or made appropriate?

Group members considered two additional examples:

- An entity uses the equity method in IAS 28 *Investments in Associates and Joint Ventures* to account for their interests in associates and/or joint ventures and presents an additional subtotal of profit before tax. If the equity pick-up of the investee's results, which is net of tax, is above the profit before tax line, should the label be amended to show "adjusted profit before tax"?
- An entity presents an additional subtotal called "revenue plus share of revenue from associates and joint ventures" even though IFRS no longer permits proportionate consolidation of revenues from joint ventures.

Group members generally did not support amending the label in the first example, and did not support presenting the subtotal in the second example. Regarding the second example above, one Group member noted that this information could be presented in the segment note disclosure when supported by the fact that it is given to the chief operating decision maker.

Another Group member observed an increasing trend in entities' financial statements that much of what an entity wants to present that does not meet the IAS 1 requirements is appearing in the segment note. Although the segment note and MD&A are nicely linked, the body of the financial statements is becoming less relevant. One CSA representative commented that they recognize non-typical GAAP measures are being disclosed as part of the segment note. However, these measures are not subtotals and should not be presented in other areas of the financial statements. When these measures are presented in the MD&A, preparers should ensure enough information is provided for users to understand what they represent.

Question 5: Where should the reconciliation of the additional subtotal to the subtotal or total required by IFRSs be presented in accordance with paragraph 85B of IAS 1?

One Group member thought that including the reconciliation on the face of the financial statements would give it too much prominence. Therefore, it would seem more appropriate to include the reconciliation in the notes to the financial statements. Another Group member noted that if there are many reconciling items between the additional subtotal and the subtotal or total required by IFRSs, this may signal the additional subtotal has strayed too far from an IFRS measurement.

One CSA representative thought that the requirement in paragraph 85B of IAS 1 is not to provide a reconciliation, but rather that line items in the statement of profit or loss should be in sequence and add to each subtotal.

Issue 2: Consider the interaction of disclosures that may be provided in the financial statements under IAS 1 with other relevant information (for example, non-GAAP financial measures and key performance indicators) that are discussed in the management commentary.

Paragraph 13 of IAS 1 states, in part, that "many entities present, outside the financial statements, a financial review by management that describes and explains the main features of the entity's financial performance and financial position, and the principal uncertainties it faces."

Regulatory requirements also play a significant role in the additional management commentary provided. For example, MD&A is described in the Ontario Securities Commission Staff Notice 52-722 "Report on Staff's Review of Non-GAAP Financial Measures and Additional GAAP Measures" as follows:

> "MD&A is an explanation, through the eyes of management, of how an issuer performed during the period covered by the financial statements and of the issuer's financial condition. MD&A supplements the financial statements and is used to improve the financial disclosure by providing a balanced discussion of the issuer's financial performance."

According to paragraph 17(c) of IAS 1, an entity is required "to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

Some proponents may hold the view that the above requirement allows for the inclusion of broad degrees of supplemental information into the financial statements (for example, information that is more commonly presented in the MD&A).

There are a number of areas in IFRSs that require or permit the financial statements to include additional information, some of which may be considered analogous to other relevant information. For example, paragraph 20 of IFRS 8 *Operating Segments* states: "an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates." The requirements in IFRS 8 permit an entity to disclose certain measures, reconciled to GAAP totals in the same manner as management views the business. Entities often disclose a combination of different financial and non-financial key performance indicators to assess performance.

On the other hand, some IFRSs allow certain specific disclosures to be presented outside the financial statements. For example, paragraph B6 of IFRS 7 *Financial Instruments: Disclosures* requires "a cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time."

The Group's Discussion

Group members observed that preparers and auditors should consider whether there is material in the financial statements that more properly belongs in the MD&A and, vice-versa, whether there is material in the MD&A that should be in the financial statements instead. For example, one Group member noted that it is troubling to see commentary about management's expectations regarding the future effect of a transaction in the financial statements because it is not possible to audit.

Group members generally thought that the distinction between the financial statements and the MD&A is clear. One Group member noted that although the various paragraphs in IAS 1 are part of a fair presentation framework, it is a very high threshold before a deviation on the grounds of fair presentation is invoked. The MD&A has a different objective than financial statements because it explains the results from management's perspective. Therefore, this Group member would not conclude that information included in the MD&A needs to be in the financial statements. However, if information is included in the financial statements because it is deemed to be relevant to a user's understanding, it should be discussed in the MD&A.

Another Group member commented that there is tension between the requirements in IAS 1 and information included in the MD&A. This Group member observed that IAS 1 is quite out-dated and does not consider today's environment because the standard was written with a presumption that there was no MD&A.

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

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 16: Capitalization of Costs

At the May 2016 meeting, the AcSB staff provided an update to the Group about the IFRS Interpretations Committee's deliberation on the issue regarding accounting for proceeds and costs of testing of property, plant and equipment. This issue is related to the Group's discussion on "IAS 16: Capitalization of Costs". The Group briefly discussed the tentative direction of the IFRS Interpretations Committee regarding the proposed amendments to IAS 16 *Property, Plant and Equipment* and raised several concerns. The Group recommended that the AcSB consider whether a submission is needed to the IFRS Interpretations Committee to highlight the underlying issue of determining when an asset is capable of operating as intended by management.

At the September 2016 meeting, the AcSB staff reported that the AcSB considered the issue at its July 2016 meeting and decided to refer the issue to the IFRS Interpretations Committee.[10]

IAS 1: Disclosures about an Assessment of Going Concern

At the May 2016 meeting, the Group recommended that this issue be discussed with the AcSB to determine whether it should be referred to the IASB or the IFRS Interpretations Committee.

At the September 2016 meeting, the AcSB staff reported that the AcSB discussed the issue at its July 2016 meeting and reflected on how the IASB had decided in November 2013 not to develop proposals on disclosure requirements about an assessment of going concern. Further, the AcSB observed that the International Auditing and Assurance Standards Board (IAASB) issued new auditor reporting standards, one of which includes a new requirement for the auditor to evaluate the adequacy of disclosures in "close call" situations. The AcSB noted that the Auditing and Assurance Standards Board is considering adopting the IAASB's new auditor reporting standards as Canadian Auditing Standards. Based on the deliberations in this area, the AcSB decided no further action is needed.

OTHER MATTERS

IFRS 3 and IFRS 11: Definition of a Business and Accounting for Previously Held Interests

In June 2016, the IASB issued an exposure draft proposing narrow-scope amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements* to clarify the definition of a business and how to account for previously held interests. The proposed amendments are intended to provide clearer application guidance to help distinguish between a business and a group of assets, and clarify the accounting for previously held interests in a business, if acquiring control, or joint control, of that business. Stakeholders were encouraged to submit their comments to the IASB before the comment period deadline.

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[10] The Group's discussion was highlighted in the IASB staff paper (Paragraph 34 of Agenda Paper 12C) when the IASB discussed the IFRS Interpretations Committee's recommendation to amend IAS 16 at its October 2016 meeting. The Group will discuss next steps for this issue at its November 29, 2016 meeting.

IAS 16: Accounting for Proceeds and Costs of Testing on Property, Plant and Equipment

At various previous IFRS Discussion Group meetings, it was mentioned that the IFRS Interpretations Committee received a request to clarify the accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management. The IFRS Interpretations Committees had recommended that the IASB propose a narrow-scope amendment to IAS 16 *Property, Plant and Equipment*. In September 2016, it further recommended that the IASB require prospective application of the proposed amendments to items of property, plant and equipment made available for use from the beginning of the earliest comparative period when first applying the proposed amendments. Stakeholders were encouraged to follow the status of this issue.

IFRS 9 and IAS 28: Measurement of Long-term Interests

At the May 2016 IFRS Discussion Group meeting, it was mentioned that the IFRS Interpretations Committee received a request relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*. In September 2016, the IFRS Interpretations Committee completed its discussion of the issue and directed the staff to prepare the ballot draft of the draft Interpretation[11] that would clarify the scope of IFRS 9 and specify how the requirements in IFRS 9 and IAS 28 apply to long-term interests. Stakeholders were encouraged to follow the status of this issue.

IAS 12: Expected Manner of Recovery of Indefinite Life Intangible Assets when Measuring Deferred Tax

The IFRS Interpretations Committee received a request to clarify how to determine the expected manner of recovery of an indefinite life intangible asset for the purposes of measuring deferred tax. The IFRS Interpretations Committee tentatively concluded that it will not add this issue to its agenda on the basis that the principle and requirements in paragraphs 51 and 51A of IAS 12 *Income Taxes* provide sufficient requirements with respect to measuring deferred tax on indefinite life intangible assets. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the comment period deadline if they have any concerns with the tentative agenda decision.

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

[11] Subsequent to the meeting, the IASB agreed with the Interpretation Committee's technical conclusions but expressed concern that the draft Interpretation would have strayed into the application of the equity method in IAS 28, in addition to specifying that long-term interests were within the scope of IFRS 9. As a result, the IASB objected to the release of the draft Interpretation, and instead instructed the staff to explore whether there is a more effective way of clarifying which Standards apply to long-term interests. At its October 2016 meeting, the IASB tentatively decided to propose amendments to IAS 28 in the next cycle of annual improvements (2015-2017) to clarify that an entity applies IFRS 9 *Financial Instruments*, in addition to IAS 28, to long-term interests.