

IFRS® Discussion Group

Report on the Public Meeting

September 22, 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.

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ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

IAS 2: Costs Necessary to Sell Inventories

On June 25, 2021, the IFRS Interpretations Committee (the Interpretations Committee) published the [Agenda Decision](#), “*Costs Necessary to Sell Inventories (IAS 2 Inventories)*,” addressing which costs an entity includes as part of “estimated costs necessary to make the sale” when determining the net realizable value of inventories.

The Agenda Decision includes the following key points:

- IAS 2 *Inventories* defines “net realizable value” as “the estimated selling price in the ordinary course of business less the estimated costs of completion and **the estimated costs necessary to make the sale**. [Emphasis added]”
- Paragraphs 28-33 of IAS 2 include further requirements about how an entity estimates the net realizable value of inventories. Those paragraphs do not identify which specific costs are ‘necessary to make the sale’ of inventories. However, paragraph 28 of IAS 2 describes the objective of writing inventories down to their net realizable value – which is to avoid inventories being carried “in excess of amounts expected to be realised from their sale.”
- The Interpretations Committee observed that, when determining the net realizable value of inventories, IAS 2 requires an entity to estimate the costs necessary to make the sale. This requirement **does not allow** an entity to limit such costs to those that are incremental. Including only incremental costs could fail to achieve the objective set out in paragraph 28 of IAS 2.
- The Interpretations Committee concluded that, when determining the net realizable value of inventories, an entity estimates the costs necessary to make the sale in the ordinary course of business. An entity uses its judgment to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

Although this Agenda Decision is clear that the entity cannot use an incremental cost approach when determining costs necessary to make the sale, it is unclear as to what additional costs should be considered. As a result, the Group considered the following Fact Pattern and discussed two issues related to applying this Agenda Decision:

1. When determining net realizable value, what are the incremental costs necessary to make the sale?
2. What costs, other than incremental costs, should be considered when determining the costs necessary to make the sale?

Fact Pattern

- Company A is a sporting goods retailer operating several retail stores in Canada. The inventory the company orders is shipped directly from the supplier to each store. The store premises are leased under long-term leases. The company does not sell merchandise online.

- Every store has a store manager, sales staff and a security guard. All sales staff are paid a fixed monthly salary. In addition, sales staff can earn a sales commission if certain products are sold. To sell slow-moving merchandise, the Company may offer point-of-sale discounts. It also undertakes marketing campaigns to promote the sale of specific products.
- At the reporting date, Company A determined that a large proportion, but not all, of the entity's inventory may not be recoverable because selling prices have declined. Accordingly, the company needs to determine the net realizable value of such inventory. In accordance with IAS 2, the company writes inventory down to the lower of cost and net realizable value on an item-by-item basis.

Issue 1: When determining net realizable value, what are the incremental costs necessary to make the sale?

Analysis

Based on the Agenda Decision, when considering “the estimated costs necessary to make the sale”, it would be appropriate to start with incremental costs. Although neither the Agenda Decision nor IAS 2 defines the term “incremental costs”, other IFRS Standards used the term to refer to costs that would not have been incurred if the entity had not entered a transaction. For example, [paragraph 92](#) of IFRS 15 *Revenue from Contracts with Customers* states: “The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).”

In the context of selling inventory, an incremental cost is one that would not be incurred if a particular sale did not occur. Therefore, a sales commission would be considered an incremental cost. In contrast, a point-of-sale discount would not be considered an incremental cost but would be factored into determining the estimated selling price when calculating net realizable value. The costs of a marketing campaign aimed at selling specific products would also not be considered an incremental cost as the cost would be incurred even if no product is sold under the campaign – that is, it is not incremental to a particular sale.

The Group's Discussion

Group members agreed with the analysis.

Issue 2: What additional costs, other than incremental costs, should be considered when determining the cost necessary to make the sale?

The Agenda Decision is clear that when determining the costs necessary to make the sale, an entity is not permitted to limit such costs to only those that are incremental. Therefore, incremental costs are but one mandatory element of the costs necessary to make the sale. However, an entity should also determine what additional costs are necessary to make the sale.

Question 1: When determining the “costs necessary to make the sale”, should an entity include direct costs necessary to make the sale?

Analysis

It would be appropriate to include some form of direct costs when determining costs necessary to

make a sale. IFRS Standards do not define what a “direct cost” is. Nevertheless, in this Fact Pattern, a “direct cost” may be considered a cost that is directly related to the selling activity or is a directly attributable cost necessary to be incurred to sell Company A’s products.

When identifying direct costs, the entity should consider the nature of its inventories, the sales channels it uses to sell products (e.g. store, online) and its cost structure. Examples of direct costs may include:

- (a) costs incurred by sales staff to sell inventory;
- (b) agency costs to sell inventory;
- (c) costs of a specific marketing campaign to sell inventory; and
- (d) transportation costs.

Given the lack of specificity in the guidance, one might consider several categories of direct costs as costs necessary to make the sale:

Category A – Direct costs related to the selling activity, incurred only at the point of sale.

Inclusion of these costs is supported by interpreting the words “costs necessary to **make** the sale” (emphasis added) as meaning those costs an entity must incur when the sale is executed (i.e., at the point of sale).

For example, if sales staff are required to sell inventory, the costs relating to the amount of time sales staff spend executing the sale (i.e., at the point of sale) would be considered a direct cost necessary to make the sale. It is directly related to the selling activity and is incurred at the point of sale. Another example of a direct cost incurred at the point of sale is the costs of packaging (e.g., bags, boxes, etc.).

Category B – Direct costs related to the selling activity, leading up to the point of sale, but excluding the point of sale.

Inclusion of these costs is supported by a broader interpretation of the words “costs necessary to **make** the sale” as being all the direct selling costs an entity must incur leading up to the point of sale.

For example, the costs would include time sales staff spent on all key steps necessary for a sale to occur (e.g., displaying product, marking down product, answering customers’ questions and helping customers select product).

Category C – Direct attributable costs necessary for inventory to be sold.

These directly attributable costs are not directly related to the selling activity but are necessary to incur for inventories to be sold.

For example, the costs of a marketing campaign directed at selling specific product would be considered a directly attributable cost because it is incurred for specific inventory to be sold. In addition, the costs to transport merchandise from one store to another store so that it is more readily available to customers would be considered a directly attributable cost as it would be a cost necessary for the sale of the product to occur.

The Group considered the following views as to which categories of direct costs should be included in determine the “costs necessary to make the sale”:

View 1A: Category A costs only;

View 1B: Categories A and B costs;

View 1C: Categories A, B and C costs;

View 1D: Categories A and C costs; and

View 1E: other views

The Group’s Discussion

Most Group members thought any combinations of Categories A, B, and C could be considered as costs necessary to make the sale, depending on an entity’s facts and circumstances.

With that said, several Group members noted that to be included in costs necessary to make a sale, direct costs should have a clear and direct link to the inventory being sold. They observed that when assessing the link between the cost and inventory, the entity should consider various factors such as the nature of the inventory sold, the industry, and its own circumstances. Among the three categories, some Group members noted that Category A costs represent the most direct link to the inventories. Whereas, Category B and C costs would require more judgment to conclude that a direct link exists between these costs and the inventories sold. One Group member observed that operationally, following View 1C (i.e. Category A, B, and C costs) to allocate costs to inventory sold can be quite onerous and complex.

Some Group members focused on the definition of net realizable value in IAS 2 that considers “costs **necessary** to make the sale” and wording used in the Agenda Decision that specifies “costs the entity **must incur** to sell its inventories” when determining the net realizable value of inventories. (Emphasis added.) They thought that for costs to be considered necessary they would need to be unavoidable from the perspective of making the sale.

Question 2: Are the direct costs and directly attributable costs necessary to make the sale required to be allocated to all inventory?

Analysis

The direct costs and directly attributable costs are not required to be allocated to all inventory, only to the inventory for which the net realizable value is required to be determined.

In accordance with [paragraph 28](#) of IAS 2, net realizable value is required to be determined for inventories for which the cost may not be recoverable. This may be due to damage, obsolescence, declining sales prices or an increase in the estimated costs of completion or the estimated costs to be incurred to make the sale.

If the costs necessary to make the sale contribute to the sale of other inventory items as well as those for which the net realizable value is being determined, the entity would allocate a portion of the total cost to the inventories in question. For example, if the marketing campaign was aimed at selling

inventory whose selling price has declined as well as other inventory, the entity would determine the proportion of the marketing campaign costs relating to the inventory whose selling price has declined and allocate that portion of the costs to such inventory.

The Group's Discussion

Group members agreed with the analysis.

Some Group members observed that in practice, the allocation of the costs to inventories described in the analysis can be complex and subjective. Therefore, significant judgement and estimation by management may be required.

Question 3: When determining the costs necessary to make the sale, is the entity required to include an allocation of indirect costs?

Indirect costs would generally refer to costs that are not directly related to the sale of inventory but are incurred to facilitate the sale of inventory.

Examples of indirect costs would include a portion of the:

- (a) store manager's costs
- (b) head office costs for the merchandising/sales department
- (c) depreciation for the store (e.g., store, fixtures)
- (d) store operating costs (e.g., heat, light, security)
- (e) general advertising and marketing costs for the company

View 3A – Yes, indirect costs are required to be included.

Proponents of this view think that in determining costs “necessary to make the sale”, an entity should include an allocation of indirect costs related to the selling effort. The indirect costs are “necessary to make the sale” of inventory as they facilitate the sale even though they are not tied to the sale of any inventory. In fact, these costs may be incurred even if the store is closed and no inventory is sold.

Proponents of this view note that to comply with the objective in [paragraph 28](#) of IAS 2 that inventories “should not be carried in excess of amounts expected to be realised from their sale or use,” a portion of these indirect costs should be allocated to the individual items of inventory when determining their net realizable value.

View 3B – No, indirect costs are not required to be included.

Proponents of this view think these costs are not necessary to make the sale because they are not costs directly associated with the sale of any specific inventory.

In addition, proponents of this view note the tentative Agenda Decision was amended from “... an entity includes **all** costs necessary to make the sale in the ordinary course of business” to “an entity estimates **the** costs necessary to make the sale” in the final Agenda Decision. (Emphasis added.) While not explicit, proponents of this view interpret the amendment as support that an entity would not be required to include indirect costs in determining the costs necessary to make the sale.

Proponents of this view also question the interaction between IAS 2 and IAS 36 *Impairment of Assets* and whether the allocation of depreciation (or the carrying amount of a long-lived asset) should factor into the net realizable test for inventory when such asset is tested for impairment under IAS 36.

The Group's Discussion

Group members supported View 3B. Some Group members noted that costs necessary to make the sale refers to the sale of specific inventories. Therefore, since indirect costs are not associated with the sales under consideration, they should not be included in the cost necessary to make the sale.

Question 4: What key steps should an entity consider when implementing this Agenda Decision?

Analysis

The entity should start with reviewing its existing accounting policy for measuring the net realizable value of inventories and determine:

- (a) Which types of costs have been identified as the “costs necessary to make the sale”?
- (b) Are the costs limited to “incremental costs” only?
- (c) Are there non-incremental costs that are necessary to make the sale that should also be included in the determination of the “costs necessary to make the sale”?
- (d) In determining the “costs necessary to make the sale”, has the entity considered the nature of its inventories, the sales channels used, and other relevant factors?

Given the judgment involved in determining the costs necessary to make the sale, the entity is encouraged to start the process early and engage with its auditors.

If the entity concludes that its accounting policy does not comply with the Agenda Decision, for example, because it excluded non-incremental costs that are necessary to make the sale when determining net realizable value, the entity needs to change its accounting policy. Any change in accounting policy is required to be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The Agenda Decision is effective for financial statements with reporting periods ending on or after June 25, 2021, subject to entities having “sufficient time” to implement an Agenda Decision. Entities should refer to the IASB article, “[Agenda decisions – time is of the essence](#)” and [Sections 8.2-8.7](#) in its Due Process Handbook for guidance on the timely implementation of Agenda Decisions.

Where the impacts of the Agenda Decision are still being analyzed and may be significant, entities should consider applying the requirements in paragraphs 30-31 of IAS 8 to disclose information on the expected timing and the possible impact that applying the Agenda Decision will have on the entity's financial statements.

The Group's Discussion

Group members agreed with the analysis. One Group member commented that given the judgment involved in determining costs to be included in the costs necessary to make a sale in some

industries, entities should disclose significant judgments made in the process of applying their accounting policies in accordance with [paragraph 122](#) of IAS 1 *Presentation of Financial Statements*.

One Group member observed that an entity in the agricultural industry may recognize a “day-one loss” when applying this Agenda Decision to measure agricultural inventory after harvest. This is because [IAS 41 Agriculture](#) requires agricultural produce to be measured at its fair value less costs to sell at the point of harvest, which are limited to incremental costs. When these products are reclassified as inventories, the net realizable value may be lower. As a result, the inventory may have to be written down to the net realizable value. Another Group member noted that this issue was also raised by some respondents in their comment letters to the tentative agenda decision. The description of this issue and the IASB technical staff’s analysis are included in the agenda paper for the [June 2021](#) Interpretations Committee meeting.

The Group’s discussion of these issues raises awareness about the Interpretations Committee’s agenda decision on which costs an entity includes in estimated costs necessary to make a sale. No further action was recommended to the AcSB.

Accounting for Crypto Assets Held on Behalf of Others

Crypto trading platforms (“Platforms”) facilitate the buying and selling of crypto assets and may also perform functions similar to one or more of exchanges, alternative trading systems, clearing agencies, custodians and dealers¹. Platforms allow clients to trade crypto assets for other assets, such as fiat money, or for other crypto assets. They also regularly hold crypto assets in a custodian capacity, securely store and protect the crypto assets for clients. The terms and conditions for such arrangements can vary significantly.

Platforms store crypto assets for clients in a shared (commingled) wallet or in segregated wallets for each individual client. Each wallet has corresponding public and private keys that are generated together as part of the private-public key pairs. A public blockchain address is the identification (ID) where the crypto assets are held and a possible destination of crypto assets, functioning like an e-mail address. A public blockchain address is a shortened version of the public key. A shared wallet is where the same wallet is used to facilitate transactions relating to multiple clients. A separate wallet may be used to facilitate transactions for each individual client on the blockchain.

Private keys are secure passcodes used to unlock and spend crypto assets belonging to a specific blockchain wallet address. Private keys are stored in either software wallets or hardware wallets, also known as “hardware security modules”. Software and hardware wallets keep the private keys safe using encryption and allow for the signing of transactions after the user has entered the correct password to access the private key.

¹ Canadian Securities Administrators. “[Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Staff Notice 21-329 Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements.](#)” March 29, 2021. The CSA’s document provides guidance on how Canadian securities legislation applies to Platforms facilitating or proposing to facilitate trading of contracts involving crypto assets or crypto assets that are securities or instruments.

The Group discussed factors to consider when assessing whether crypto assets held by the Platform on behalf of others should be recognized in the Platform's statement of financial position.

Issue 1: What considerations should be made in assessing whether a Platform should record the client crypto assets in its statement of financial position?

Analysis

Current IFRS Standards do not directly provide guidance on whether an entity's holding of crypto assets on behalf of others should be presented on its statement of financial position. Therefore, entities should consider the guidance in [IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#) when developing an accounting policy for such assets.

The accounting for the crypto assets held by Platforms is either on balance sheet as a crypto asset with a corresponding liability, or off balance sheet for the crypto assets to be considered "held-in-trust" for their clients. The on-balance-sheet treatment is consistent with how banks and brokers account for customer's cash deposits. The off-balance-sheet treatment is consistent with how brokers account for stocks and bonds held on behalf of their customers.

Therefore, as with traditional custodians of client money, the assessment should focus on the concepts of "control" and "benefits". The Platform should assess whether it is subject to substantial risks and rewards incidental to asset ownership. To determine this, the Platform should consider the terms of the agreement with its clients, the laws governing the jurisdiction(s) in which it operates and how it manages and stores crypto assets held on behalf of clients. Some of the considerations include:

- (a) local laws and regulations, in particular those around legal ownership of assets held by others;
- (b) the extent to which the parties' rights and obligations are clear or contractually enforceable;
- (c) analysis of which party has legal title to the asset;
- (d) the status of the crypto assets in the event of the custodian's bankruptcy or insolvency (i.e., are the crypto assets available to satisfy general claims from the custodian's creditors in the event of its bankruptcy);
- (e) the contractual limitations on the custodian's use and transfer of the crypto assets, including whether the custodian is required to keep matching holdings of crypto assets at all times;
- (f) whether the entity has the ability to "borrow" the crypto asset and use it for its own purpose or to lend the crypto assets to third parties;
- (g) whether the arrangement allows for commingling client and custodian crypto assets (i.e., is the custodian required to keep its clients' crypto assets in a different digital wallet from its own crypto assets);
- (h) whether crypto assets held on behalf of others are held in an account/wallet of the entity or in an account/wallet at a third party (i.e. a sub custodian);
- (i) traceability to a dedicated blockchain address (not all transactions can be individually traced to a dedicated blockchain address);

- (j) whether regulatory or contractual requirements are imposed on the custodian regarding appropriate record keeping and internal controls;
- (k) whether the agreement with the client is clear that the custodian is holding the crypto assets in the capacity of an agent and whether the substance of the arrangement is consistent with an agent's rights and responsibilities;
- (l) whether the access to clients' crypto assets require a multi-signature authorization by both the client and the custodian, or whether the custodian has unilateral access to the private key; and
- (m) whether the custodian bears the security risk (i.e., is the custodian obligated to reimburse the client for any crypto assets lost in a security breach).

The Group's Discussion

Most Group members agreed with the analysis. They analogized crypto assets to client money and agreed the assessment should focus on whether the Platform is acting in the capacity of the principal and is subject to substantial risks and rewards incidental to ownership of the crypto assets. One Group member analogized crypto assets as non-cash collaterals and thought the Platform could consider the guidance in [paragraph 3.2.23](#) of IFRS 9 *Financial Instruments* to account for the non-cash collateral when accounting for these assets.

Several Group members emphasized the importance of the control assessment in the Platform's accounting for crypto assets and thought the considerations included in the analysis are useful in this assessment. They observed that the Platform's client agreements are often complex and unique to each transaction. In addition, some Group members noted that some Platforms may operate in both banking like and broker like models. Therefore, they noted that Platforms should review these agreements in detail to understand each party's rights and obligations and whether these contractual rights are enforceable when assessing control. A representative from the Canadian Securities Administrators (CSA) commented that some client agreements may appear to provide rights to clients that indicate the Platform is acting in an agent capacity. However, when considering other factors identified in the analysis, this may not be the case. For example, to assess the legal ownership of crypto assets, the Platform needs to consider where these assets are stored to determine whether the client's rights are enforceable under the local law. Given the complexity and technical nature of client agreements, a legal opinion may be needed in the control assessment.

In addition to the factors listed in the analysis, one Group member noted that another factor to consider in the control assessment is the Platform's ability to safeguard crypto assets stored against potential hacks or breaches of data.

Issue 2: Should the Platform record client crypto assets in its statement of financial position in the following Fact Patterns?

Fact Pattern 1

- Entity A is a Canadian Platform that hosts crypto wallets and offers exchange services.
- Entity A's Client Agreement stipulates that Entity A:
 - (a) offers a shared wallet (commingled) as opposed to segregated wallets and uses shared blockchain addresses;

- (b) can, at its discretion at any time, apply any of the funds and digital assets allocated to the client's account to set-off or satisfy any amounts the client may owe to Entity A;
 - (c) is not prohibited from lending the crypto assets out to other parties, or from making use of the crypto assets while they are in its possession;
 - (d) accepts no liability for losses that an entity may incur related to its action or inaction around certain activities involving the crypto assets, including security-related risks.
- Entity A obtained a legal opinion which indicates that the crypto assets would be available to settle general claims from Entity A's creditors in the event of bankruptcy.

Analysis

A commingled wallet presents higher risks for clients because the deposited crypto assets originally allocated to one client could be used to benefit another client or Entity A itself. Further, the legal opinion supports that the crypto assets are available for general claims from Entity A's creditors in the event of bankruptcy.

The factors above and the absence of language in the Client Agreement limiting the use and transfer of the crypto assets, imposing appropriate record keeping and other terms indicate that Entity A is holding the crypto assets in the capacity of a principal. Thus, Entity A is subject to substantial risks and rewards incidental to ownership of the assets under its control. Therefore, Entity A should record the client crypto assets in its statement of financial position with an offsetting liability representing the obligation to the client.

An analogy of this accounting treatment can be drawn to how a bank presents its client's cash. The cash is commingled in the bank's account with the Bank of Canada. It is available to the bank to lend out for mortgages, lines of credit, credit cards, and other investments. The cash is presented on the bank's balance sheet, with an offsetting customer liability.

Where significant judgments have been made in determining whether Entity A should recognize the client crypto assets in its statement of financial position, Entity A should provide disclosure in accordance with [paragraph 122](#) of IAS 1 *Presentation of Financial Statements*.

The Group's Discussion

Most Group members agreed with the analysis presented in the Fact Pattern. They noted that Entity A is holding crypto assets in the capacity of a principal and should record the client crypto assets in its statement of financial position.

One Group member thought the crypto assets should not be analogized to cash given they are not cash instruments. Instead, this Group member analogized crypto assets as non-cash collateral and thought they should be disclosed on the Platform's financial statements and only be recognized as an asset when the Platform uses them.

Fact Pattern 2

- Entity B is a Canadian Platform that hosts crypto wallets and offers exchange services.
- Entity B's Client Agreement stipulates that Entity B:
 - (a) offers a shared wallet (commingled) as opposed to segregated wallets and uses shared blockchain addresses;
 - (b) Records the ownership of crypto assets will be clearly recorded in its books and records as belonging to the client and stored in a custody account on behalf of the client, and that the records will at all times identify the client's crypto assets separately;
 - (c) has no rights, interest or title to the crypto assets;
 - (d) Will use none of the crypto assets in connection with any loan, lien or claim; and
 - (e) Is the custodian and the sole entity with access to the private key. The client must authorize all transactions, but Entity B will only act on its clients' direction.
- Entity B obtained a legal opinion which supports that the crypto assets are not available to settle general claims from Entity B's creditors in the event of bankruptcy.

Analysis

Although Entity B uses a commingled wallet, separate record keeping allows for the separate identification of the client's crypto assets. Furthermore, the language in the Client Agreement specifies that the client must authorize all transactions, and the custodian can only act on the direction of the client. These factors indicate that Entity B is holding the crypto asset in the capacity of an agent.

Therefore, despite the arrangement allowing for comingling of crypto assets in the wallet, Entity B is not subject to substantial risks and rewards incidental to ownership of the assets given that it is acting in its capacity as an agent. Therefore, Entity B should not record the client crypto assets in its statement of financial position.

An analogy of this accounting treatment can be drawn to the broker's accounting for the securities it holds on-behalf of its clients. For example, a broker may hold a client's securities that are commingled with other clients' securities in a Canadian Depository for Securities (CDS) account. Although the CDS recognizes the broker as the owner of the securities, the broker maintains client sub-ledgers clearly identifying each client's ownership in the pool of securities. In addition, the broker is not authorized to transact using the client's securities without the client's approval. Therefore, the securities belong to the clients and are not recorded on the broker's balance sheet, even though these securities are in a commingled CDS account.

Where significant judgments have been made in determining whether Entity B should recognize the client's crypto assets in its statement of financial position, Entity B should provide disclosure in accordance with [paragraph 122](#) of IAS 1.

The Group's Discussion

Group members agreed with the analysis.

A representative of the CSA noted that even though the crypto assets are not presented on Entity B's balance sheet, given the importance of these managed assets to Entity B's performance, it should consider whether additional information needs to be included in a note in its financial statements. Information such as the types of clients' assets may provide useful information to financial statement readers.

One Group member commented that the custodian of the crypto assets is providing a service. Thus, the entity should analyze this service under [IFRS 15 Revenue from Contracts with Customers](#) and provide required disclosures.

The Group's discussion of these issues raises awareness about the factors a Platform should consider when assessing whether it has control over client's assets. Given the prominence of crypto assets in the market, one Group member highlighted the need for the IASB to develop standards specifically for crypto currencies. Staff from the AcSB commented that the topic of accounting for crypto currency is highlighted as a priority project in the AcSB's response letter to the IASB's agenda consultation request. No further action was recommended to the AcSB.

IFRS 9: Issuer's Accounting for Green Bonds

Green bonds are debt instruments where the interest rate is linked to certain environmental, social and governance (ESG) metrics. Green bonds include contractual terms that cause cash flows to vary depending on whether certain ESG metrics are met (ESG features).

Some examples of ESG features include:

- A global crude oil trading company issues a loan where its base interest rate is the Canadian dollar offered rate (CDOR) plus 1 per cent, but the margin is adjusted every year based on the status of its total sustainability score. The total score is calculated based on a predetermined formula using sustainability key performance indicators (KPIs), including air emissions, oil spills and employee safety measures. The margin adjustment is based on the following table:

Sustainability program status	Total score	Adjustment to margin
Successful completion	180-230	Sustainability discount (-0.05%)
Regular completion	100-179	Zero (no change)
Non-successful completion	0-99	Sustainability premium (+0.025%)

- A telecommunications company issues a loan for general corporate purposes. The interest rate on the loan is 4 per cent but will increase by up to 0.05 per cent if certain social and governance metrics are not maintained. These metrics are based on:
 - the percentage of women on the board of directors and in the company's total workforce;
 - the number of training hours for employees; and
 - the number and severity of data breaches.

The Group discussed the following three issues on how ESG features affect the issuer's accounting for green bonds measured at amortized cost.

Issue 1: Are ESG features required to be separated and accounted for as derivatives by the issuer?

Analysis

[Paragraph 4.3.3](#) of IFRS 9 *Financial Instruments* states: “[An] embedded derivative shall be separated from the host contract and accounted for as a derivative... if and only if:

- (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs B4.3.5 and B4.3.8);
- (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 recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).”

Assuming conditions (a) and (c) are met, the focus of the analysis is condition (b) and determining whether the ESG feature would meet the definition of a derivative.

[Appendix A](#) of IFRS 9 defines a derivative as “[a] financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

- (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').
- (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- (c) it is settled at a future date.”

The key factor to determining if an ESG feature meets the definition of a derivative will be whether the underlying feature is a non-financial variable that is specific to a party to the contract.

The issuer will need to apply judgement and consider the nature of each ESG feature. ESG features are specific to the issuer if they relate to the issuer's operations and are intended to drive the issuer to meet predetermined sustainability performance objectives. In addition, ESG features related to “physical” variables or measures and do not have financial elements to them would be considered to have non-financial variable underlying (e.g., the amount of greenhouse gas the issuer emits). ESG features that do not meet the definition of a derivative would not be separately accounted for as a derivative.

The Group's Discussion

Group members agreed with the analysis and highlighted that determining whether the ESG features meet the definition of a derivative will depend on whether the features are non-financial variables that are specific to the issuer.

Some Group members thought that the examples of the ESG features included in the analysis appear to be non-financial and specific to the issuer. Therefore, these ESG features do not meet the definition of a derivative. However, they emphasized the need to carefully analyze the specific ESG features in the agreement when assessing whether the feature meets the definition of a derivative.

Issue 2: If no embedded derivative is required to be separated for ESG features, does the guidance on floating rate financial instruments apply to changes in cash flows resulting from ESG features?

View 2A– The guidance on floating rate financial instruments is not applicable

Proponents of this view note that paragraph B5.4.5 of IFRS 9 states: “For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate.” They think the changes in the interest payments due to ESG features do not reflect changes in market rates of interest.

Consequently, paragraph B5.4.5 of IFRS 9 is not applicable and the issuer should follow the guidance in paragraph B5.4.6 of IFRS 9. Changes in estimated interest payments would result in the issuer recording adjustments to the amortized cost of the loan with the corresponding income or expense being recognized in profit or loss.

View 2B– The guidance on floating rate financial instruments is applicable

Proponents of this view note that IFRS 9 does not define of “floating rate” and does not have guidance on how the term “market rates of interest” should be interpreted.

At its [October 2008](#) meeting, the IASB discussed a floating rate financial instrument as “an instrument with contractual variable cash flow amounts arising from changes in market variables” and tentatively agreed to provide clarification as part of its Annual Improvements project. However, at its [June 2009](#) meeting, the IASB decided to defer any amendments and subsequently this topic was not pursued.

In the absence of specific guidance, proponents of this view think changes in estimated interest payments due to ESG features reflect changes in market interest rates for such loans. Consequently, changes in estimated interest payments due to ESG features would adjust the effective interest rate (EIR).

There are two approaches to applying the floating rate guidance. Under the first approach the current period EIR and the interest accrual would be based on the current level of interest (based on current ESG metrics). The second approach would be to calculate and update the EIR based on projected interest payments taking into account expectations and changes in these expectations (based on current and projected ESG metrics).

Proponents also note that compared to View 2A, View 2B would result in a less volatile profit or loss.

The Group's Discussion

Group members thought either View 2A or 2B may be appropriate depending on the issuer's specific facts and circumstances.

Most Group members noted that View 2B applies if the interest rate movement from the ESG feature is expected to reflect changes in the issuer's credit risk. They observed that making this determination requires judgment and the issuer should consider its specific facts and circumstances when analyzing the terms in the loan agreement. One Group member commented that one assessment is to compare two recently issued loans where the only difference between them is the ESG features present in one. The issuer should analyze whether the difference in the interest rate reflects the issuer's credit risk. Another Group member observed that in cases where the ESG features have a small impact on the cash flows of the loan, the difference between View 2A or 2B may not be material to the issuer's financial statements. As a result, if not material, the issuer might apply View 2B to avoid the complexity of calculating the catch-up adjustments required by View 2A.

Issue 3: If a loan with ESG features is convertible into shares of the issuer, would the conversion feature meet the equity classification criteria?

Fact Pattern

- On July 1, 20X1 an industrial company, Company A, issues convertible bonds that matures on June 30, 20X6. The bondholders can convert the bonds at any time into common shares of Company A with a fixed conversion ratio (one common share for one bond).
- The contractual terms of the bond include a provision whereby if Company A does not meet certain ESG criteria by December 31, 20X5, Company A must pay bondholders an amount equal to 10 per cent of the bond's nominal value ("penalty amount").
- If the bonds have not been converted by that date, the penalty amount is due in cash and does not impact the conversion ratio. The bonds remain convertible until the maturity date.
- If the bonds have been converted before that date, the ESG criteria are not assessed and no penalty amount is due.
- The ESG criteria are for air emissions by the issuer and are based on limits set by statutory regulations. Company A has assessed that the ESG feature has a direct influence on its credit risk.

View 3A– The conversion option fails the fixed-for-fixed criteria and represents a separable embedded derivative

Proponents of this view note that bondholders will consider the likelihood of Company A paying a penalty when deciding whether to exercise their conversion options. Therefore, the penalty amount impacts the investor's economic decisions and is not distinct from the conversion option. Therefore, the cash penalty that is due if Company A fails the ESG criteria cannot be ignored when assessing whether the fixed-for-fixed criteria in [IAS 32 Financial Instrument: Presentation](#) is met.

Since the penalty payment is only triggered when Company A fails to meet the ESG criteria and the bonds have not been converted by December 31, 20X5, proponents of this view think the settlement

amount for the converted common shares varies over the term of the bonds. As a result, the conversion option fails the fixed-for-fixed criteria.

The conversion option would be separated and accounted for as an embedded derivative (unless the instrument is designated at fair value through profit or loss). Company A would also need to determine whether the ESG feature and the conversion feature have to be treated as a single compound embedded derivative (this may depend on the conclusions in Issue 1).

View 3B– Because the penalty is unrelated to the conversion, the conversion option does not fail the fixed-for-fixed criteria and should be classified as an equity component

Proponents of this view think the cash penalty that is due if Company A fails the ESG criteria by December 31, 20X5 does not relate to the conversion option. The penalty amount is always paid in cash and does not affect the conversion ratio that remains fixed.

[Paragraph 22](#) of IAS 32 gives an example of an equity instrument as “an issued share option that gives the counterparty a right to buy a fixed number of the entity’s shares for a fixed price or for a fixed stated principal amount of a bond.” The principal amount of the bonds subject to the conversion option remains “fixed and stated” and is not affected by the ESG feature. The variation of the debt’s carrying amount due to the ESG feature does not prevent the fixed-for-fixed criteria from being met because the amount that is converted remains the fixed principal amount.

Accordingly, the ESG feature should be assessed as a characteristic of the debt component and should be ignored when assessing whether the conversion option meets the fixed-for-fixed criteria.

View 3C– the conversion option does not fail the fixed-for-fixed criteria because the ESG feature has a direct influence on Company A’s credit risk

Proponents of this view note that because it has a direct influence on Company A’s credit risk, the ESG feature represents a component of credit risk. Therefore, the changes in the contractual cash flows resulting from the penalty reflect movements in market rates of interest specific to Company A.

Paragraph 22 of IAS 32 states: “Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument.” Since the variability the ESG feature creates reflects a partial reset to market rates of interest specific to Company A, it is considered a floating rate and the “fixed cash” criteria are not breached.

The Group’s Discussion

Group members thought both View 3B and 3C have merit.

Some Group members supported View 3B. They noted that the principal amount of the bonds subject to the conversion option remains “fixed and stated” and is not impacted by the ESG feature. The penalty paid in cash is viewed as an additional interest charge.

Other Group members supported View 3C in the fact pattern presented which stated the ESG feature has a direct influence on the issuer’s credit risk. As such, the changes in the contractual cash flows resulting from the penalty reflect movements in market rates of interest specific to the issuer.

Group members also noted that the accounting outcome is the same for the issuer when applying these two views.

In addition to the issuer's accounting discussed at the meeting, one Group member commented that at its [July 2021](#) meeting, the IASB discussed the accounting for green bonds from the investor's perspective. The discussion focused on key factors an investor needs to consider in its analysis to determine how to apply the requirements in [IFRS 9](#).

Overall, the Group's discussion raises awareness of the issuer's accounting for green bonds that are measured at amortized cost. 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 with the International Accounting Standards Board (IASB) 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.

At its meeting in June 2021, the IASB tentatively decided to amend IAS 1 in response to new information provided by respondents to the tentative Agenda Decision.

The proposed amendments to IAS 1 would:

- modify the requirements introduced by *Classification of Liabilities as Current or Non-current* (2020 amendments) on how an entity classifies debt and other financial liabilities as current or non-current in particular circumstances; and
- defer the effective date of the 2020 amendments to no earlier than 1 January 2024.

The IASB plans to publish its exposure draft in November 2021.

OTHER MATTERS

Third Agenda Consultation

The IASB published its Request for Information - "[Third Agenda Consultation](#)," in March 2021, seeking views on what its priorities should be over the next five years. The comment period deadline was September 27, 2021.

Initial Application of IFRS 17 and IFRS 9- Comparative Information

The IASB issued an [Exposure Draft](#) proposing an amendment to IFRS 17 *Insurance Contracts*. The amendment is targeted in nature to improve the usefulness of comparative information presented on initial application of IFRS 17 and [IFRS 9](#) *Financial Instruments*. The comment period deadline was September 27, 2021.

AcSB Draft Strategic Plan 2022-2027

The [AcSB's Draft Strategic Plan](#) focuses on enhancing the relevance of financial and non-financial information reported. The Board proposes three strategies to address Canadian stakeholders' changing needs:

- deliver relevant and high-quality accounting standards;
- demonstrate leadership in reporting beyond traditional financial statements; and
- raise the Board's international influence.

The comment period deadline for this document was October 15, 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.

At its July meeting, the IASB decided to extend the comment period for this Exposure Draft from October 2021 to January 2022. This extension allows more time for preparers to conduct fieldwork and provide feedback on the proposals' practical application.

Canadian stakeholders are encouraged to submit their comments to the IASB by January 12, 2022.

PRIVATE SESSION

The Group's mandate includes assisting the AcSB in influencing the development of IFRS Standards (e.g., advising 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 Comment

At its June 2021 meeting, the Group provided input on the following documents for comment to assist in the development of the AcSB's response letters:

- IASB's Request for Information- "[Third Agenda Consultation](#)"
- IASB's Exposure Draft- "[Disclosure Requirements in IFRS Standards, a Pilot Approach](#)"

At its September 2021 meeting, the Group provided input on the AcSB [Draft Strategic Plan 2022-2027](#).