

IFRS[®] Discussion Group

Report on the Public Meeting

December 12, 2019

The IFRS Discussion Group's purpose is to act in an advisory capacity to assist the Accounting Standards Board (AcSB) in supporting the application in Canada of IFRS[®] Standards. The Group maintains a public forum at which issues arising from the current application, or future application, of issued IFRS Standards are discussed and makes suggestions to the AcSB to refer particular issues to the International Accounting Standards Board (IASB) or IFRS Interpretations Committee. In addition, the Group provides advice to the AcSB on potential changes to IFRS Standards and such discussions are generally held in private.

The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the AcSB.

The discussions of the Group do not constitute official pronouncements or authoritative guidance. This document has been prepared by the staff of the AcSB and is based on discussions during the Group's meeting. For a full understanding of the discussions and views expressed at the public meeting, listen to the [audio clips](#).

Comments made in relation to the application of IFRS Standards do not purport to be conclusions about acceptable or unacceptable application of IFRS Standards. Only the IASB or the IFRS Interpretations Committee can make such a determination.

ITEMS PRESENTED AND DISCUSSED AT THE DECEMBER 12, 2019 MEETING

[IFRS 16 and IAS 16: Lease Term and Useful Life of Leasehold Improvements](#)

[IFRS 16: Application of Definition of Lease to a Surface Right](#)

[IFRS 15, IFRS 16, IAS 2, and IAS 41: Impacts of IFRS 16 on Inventory Costing, Revenue Recognition, and Biological Assets](#)

[IAS 19 and IAS 34: Pension Remeasurement for Significant Market Fluctuations during an Interim Period](#)

[IFRS 3 and IAS 12: Deferred Taxes on Goodwill in a Business Combination](#)

[IAS 36: Climate Change and Asset Impairment](#)

[IAS 32: Classification of Limited Partnership Units](#)

[IAS 19: Long-term Bonus Plans Contingent on Future Events or Performance](#)

[International Accounting Standards Board's 2020 Agenda Consultation](#)

PREVIOUS ITEMS DISCUSSED BY THE GROUP

[IFRS 16: Right to Control Assessment](#)

[IFRS 3, IAS 12, IFRIC 23: Uncertain Tax Position Acquired in a Business Combination](#)

[IFRS 16: Sales-leaseback Transaction with Variable Payments](#)

[IFRS 16 and IAS 37: Variable Lease Payments and Onerous Lease Provisions](#)

OTHER MATTERS

[Reminders on IASB® Documents for Comments](#)

[Classification of Liabilities as Current or Non-current \(Amendments to IAS 1\)](#)

[Goodwill and Impairment](#)

ITEMS PRESENTED AND DISCUSSED AT THE DECEMBER MEETING

IFRS 16 and IAS 16: Lease Term and Useful Life of Leasehold Improvements

The IFRS® Interpretations Committee received a request on two application issues under IFRS 16 *Leases*:

1. How to determine the lease term of a cancellable lease or a renewable lease¹. Specifically, whether the entity should consider the broader economics of the contract instead of only the contractual termination payments when applying paragraph B34 of IFRS 16 and assessing “no more than an insignificant penalty.”
2. Whether the useful life of any related non-removable leasehold improvements is limited to the lease term determined under IFRS 16.

In response, the IFRS Interpretations Committee issued an [Agenda Decision](#) in December 2019. The Committee observed that, in applying paragraph B34 of IFRS 16 and determining the enforceable period of the lease described in the request, an entity should consider:

- the broader economics of the contract beyond contractual termination payments. For example, if either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination that is more than insignificant, the contract is enforceable beyond the date on which the contract can be terminated; and
- whether each of the parties has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

¹ The cancellable lease described in the request is one that does not specify a particular contractual term but continues indefinitely until either party to the contract gives notice to terminate. The contract includes a notice period of, for example, 12 months and the contract does not oblige either party to make a payment on termination. The renewable lease described in the request is one that specifies an initial period and renews indefinitely at the end of the initial period unless terminated by either of the parties to the contract.

The Group was asked to consider how to apply this recent Agenda Decision to various fact patterns, including month-to-month leases.

Fact Pattern 1

- Company A (lessee) operates a mine site in a remote area in northern Canada and has recently begun extracting the minerals from the ground.
- On January 1, 2019, Company A enters into a contract with Company B (lessor) to rent a piece of extraction equipment to be used at that mine site. Assume the contract meets the definition of a lease under IFRS 16 and that the useful life of the extraction equipment is five years.
- The contract has an initial term of one year and will continue to renew monthly, unless either party terminates the contract with one-month's notice (i.e. a month-to-month lease). The contract does not stipulate any contractual termination payment.
- There is a strong market for this type of extraction equipment. Therefore, Company B would not incur more than an insignificant penalty if the contract did not continue past the initial one-year term (any transportation costs would be considered insignificant to Company B).
- The extraction process is expected to take place over the next three years through to December 31, 2021. The process and time to replace the equipment would significantly disrupt Company A's operations. Such disruption will cause Company A to incur additional operating costs such as wages, interest cost, and additional rental cost for another piece of equipment.

Issue 1: How should Company A apply the above Agenda Decision to assess the lease term?

Analysis

The minimum potential lease term is the non-cancellable period of one year. To determine the enforceable period, Company A determines the point at which both the lessee and lessor can terminate the lease without permission from the other party and with no more than an insignificant penalty. In Fact Pattern 1, this point is after three years because terminating the lease before the extraction process is completed will result in significant additional operating costs for Company A.

When the enforceable period of three years extends beyond the one-year non-cancelable period, Company A applies paragraphs 19 and B37-B40 of IFRS 16 to assess the lease term. After the initial lease term, the contract becomes month-to-month with each month being considered an additional renewal option. Due to the importance of the underlying asset to Company A's operations and the significant costs to replace that asset, Company A is reasonably certain to exercise the renewal option until the end of three years.

Therefore, in Fact Pattern 1, the lease term is three years.

The Group's Discussion

Group members agreed with the analysis.

Several Group members pointed out that the guidance in IFRS 16 regarding determining a lease term appears to be "one-sided". The guidance focuses on whether the lessee is reasonably certain to

exercise a renewal option but ignores the lessor's ability to terminate the lease. One Group member noted that at the lease commencement date, due to limited information provided by the lessee, it may be difficult for the lessor to evaluate the extent of the lessee's penalties associated with terminating the lease as well as the lessee's intention related to exercising a renewal option. Another Group member noted that the lessor, without such information, may determine the term of the lease based on the ability of both parties to cancel the lease after one year. As a result, the lessor may conclude the lease term is one year instead of three years.

Some Group members questioned whether Company A is reasonably certain to exercise the renewal option at the end of three years. One Group member thought that it is possible that the mine may be depleted sooner than originally estimated and therefore, the lessee may not exercise the renewal option. Another Group member noted that when determining whether to reassess the certainty of exercising an extension option after the lease commencement date, the lessee should apply paragraph 20 of IFRS 16 to evaluate whether the changes in the circumstances are within its control. Changes in circumstances that are outside the control of the lessee would not result in a revision to the lease term. Overall, Group members emphasized the need to examine specific facts and circumstances when evaluating whether the lessee is reasonably certain to exercise the renewal option.

Fact Pattern 2

- Company X (lessee) is a retailer who enters into an agreement on January 1, 2019, with Company Z (lessor) to rent a commercial unit in a shopping centre. Assume the agreement meets the definition of a lease under IFRS 16.
- The contract specifies that neither party can exit the lease during the initial two-year term. Thereafter, the lease will continue to renew until either party terminates the contract, subject to a six-month notice period. The contract does not stipulate any contractual termination payment. After the initial term, the lessor has no more than an insignificant penalty to terminate the lease.
- The base rent represents the market terms for similar leases at the time the contract was entered into and is indexed annually to the Consumer Price Index.
- The lessee constructs significant leasehold improvements which have an economic life of five years. Upon termination of the lease, these leasehold improvements will be abandoned.
- Company X concludes the lease term is four years because after this point it will not incur more than an insignificant penalty to terminate the lease. However, Company X expects to continue to use the underlying asset for five years.

Issue 2: How should Company X determine the useful life of the leasehold improvements?

View 2A – The useful life of leasehold improvements is limited to the lease term, which the lessee has determined to be four years, as set out above.

Proponents of this view think that in assessing the useful life of the immovable leasehold improvements, Company X should apply paragraph 57 of IAS 16 *Property, Plant and Equipment* which states, “The useful life of an asset is defined in terms of the asset’s expected utility to the entity. ...The useful life of an asset may be shorter than its economic life”. As such, proponents argue that Company X obtains utility so long as it remains in the leased premises.

Furthermore, the IFRS Interpretations Committee (IFRIC) Agenda Decision also noted that entities would often reach a conclusion that the useful life of leasehold improvements would be consistent with the related lease term.

Therefore, the useful life of the leasehold improvements is four years.

View 2B – The useful life of the leasehold improvements is five years, despite the fact that the lessee had determined the lease term to be four years.

Proponents of this view think that because Company X expects to use the underlying asset for five years, the expected utility of the leasehold improvement should be five years. Therefore, applying paragraph 57 of IAS 16, the useful life of the leasehold improvement is five years.

In this case, the useful life of the leasehold improvements is inconsistent with the lease term because the lease term is limited by the enforceable period of four years.

The Group’s Discussion

Group members discussed whether the term of the lease is in fact four years, as concluded in the fact pattern.

Some Group members noted that Company X expects to continue to use the leasehold improvements for five years (i.e., expected useful life), and if the lease is terminated at the end of the fourth year, the remaining value of the leasehold improvements’ useful life would be more than an insignificant penalty to the lessee. As a result, these Group members thought that the enforceable period of the lease would be five years.

Other Group members noted that in practice, the useful life of a leasehold improvement is often tied to the associated lease term. Therefore, entities would typically negotiate a renewal option in the lease contract in order to utilize the leasehold improvements for the duration of their expected useful life.

Furthermore, a few Group members noted that in practice, the useful life of the leasehold improvements often does not exceed the lease term. That said, in certain circumstances, it is possible for leasehold improvements to have a useful life that is longer than the lease term. However, Group members emphasized that in these circumstances, entities would need to carefully consider if the lease term has been determined appropriately.

Fact Pattern 2A

- Assume the same facts as described in Fact Pattern 2, except that after two years the contract is silent on the parties’ rights and obligations. As such, the contract does not state that the lease will continue to renew until either party terminates the contract with a six-month notice period.

- Further, assume that the local legal framework supports that a contract remains enforceable as long as the lessee remits payment and the lessor continues to accept the payment in exchange for use of the underlying asset. One such legal framework is the Civil Code of Québec which supports that under certain conditions a commercial lease may remain enforceable past the period contemplated in the contract. Under Sections 1878 and 1879 of the Civil Code of Québec (emphasis added): “A lease with a fixed term may be renewed. The renewal must be express, **unless the lease is of an immovable, in which case the renewal may be tacit...** and a lease is renewed tacitly where the lessee continues to occupy the premises for **more than 10 days** after the expiry of the lease without opposition from the lessor. In that case, **the lease is renewed for one year** or for the term of the initial lease, if that was less than one year, on the same conditions. The renewed lease is also subject to renewal.”²

Issue 3: How should the lease term be assessed in the above fact pattern?

View 3A – If the local legal framework supports that the contract remains enforceable, the lease term would be assessed similarly to a renewable or cancellable lease as discussed in Fact Pattern #1.

Under this view, because the Civil Code of Québec enforces the contract to another year so long as Company X occupies the property more than 10 days without the opposition from the landlord, this contract effectively is a year-to-year lease.

Therefore, applying the assessment performed for Fact Pattern 1, proponents of this view argue that the lease term is the four-year enforceable period. This is because Company X has determined that it is reasonably certain to exercise its legal rights to remain in the leased premise for four years due to the investment in the leasehold improvements.

View 3B – The assessment of the lease term is limited to the expiry of the lease.

Proponents of this view think that at any point during the 10-day period the lessor can reject the lessee’s continued occupation of the premise, and the contract’s enforceability would no longer be supported by the local legal framework. Thus, when assessing the lease term on lease commencement date, Company X should disregard the potential to continue using the underlying asset after the lease’s expiry date. This is because renewing the lease is contingent on the future discrete actions by both parties.

Proponents of this view further consider the “contract” described in paragraph B34 of IFRS 16 to include either a written or verbal arrangement and other provisions supported under the local legal framework. Without having any arrangements documented in the contract or other verbal arrangements regarding lease renewal, the enforceable period under the agreement is limited to the two-year contractual period.

The Group’s Discussion

Group members had diverse views on this issue.

Some Group members preferred View 3A. They noted that the written contract may not include all necessary terms and conditions required by the local jurisdiction. One Group member said that a

² Civil Code of Québec, Articles 1877-1979 - <http://legisquebec.gouv.qc.ca/en/ShowDoc/cs/CCQ-1991>

lease could be governed by a master lease agreement across different jurisdictions. Therefore, it is important to review the terms of the lease in the context of the legal framework that governs the parties to the lease. A representative from the Canadian Securities Administrators highlighted the importance of assessing the substance over the form of the lease arrangement to identify the lessees' obligations under both the contract and the legal framework. Some Group members also thought that the landlord's option to discontinue the lease during the 10-day period is akin to a lessor's termination option. As such, they expected the accounting outcome in this Fact Pattern to be the same as under Fact Pattern 1.

Other Group members supported View 3B. Some Group members focused on the 10-day period during which the landlord can terminate the lease at any time and thought that the extension of the lease term is contingent on future discrete actions by both parties. Therefore, these Group members thought the lease term should only be two years.

Issue 4: What are Group members' views on the time to implement this IFRIC Agenda Decision?

The Group's Discussion

Group members highlighted several challenges that financial statement preparers may encounter when implementing this Agenda Decision at or near their period end date. One Group member commented that the implementation process can be complex, requiring entities to reassess impacted leases, remeasure and record any differences, and redesign or reapply internal controls. Some Group members observed that entities implementing this Agenda Decision after year end, should consider the requirements to disclose:

- the impact of accounting changes that have not yet been adopted; and
- the retrospective application of a change in accounting policy.

The purpose of the discussion is to raise awareness of the recent IFRIC Agenda Decision on lease term and useful life of leasehold improvements. No further action was recommended to the AcSB.

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

IFRS 16: Application of Definition of Lease to a Surface Right

Under IFRS 16 *Leases*, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B13-B20 of IFRS 16 provide guidance on whether an asset is identifiable. Under paragraph B20, "A capacity portion of an asset is an identified asset if it is physically distinct." But in paragraph B14, "a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use."

Paragraph B9 of IFRS 16 further requires two criteria to be met to demonstrate a lessee's right to control the use of an identified asset, being:

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

2. the right to direct the use of the identified asset.

The Group considered an arrangement between a landowner and a customer that allows the customer to place a specified number of wind turbines and associated infrastructure on a plot of agricultural land. The Group discussed what is the identified asset and whether the customer has the right to obtain substantially all of the economic benefits from the use of that identified asset under IFRS 16.

Fact Pattern

- A landowner (“Landowner”) with a plot of agricultural land enters into an agreement for a specified period of time with Entity X (“Customer”) allowing the Customer to place a specified number of wind turbines and associated infrastructure on the plot of land.
- The Customer will decide where within the plot of land each wind turbine will be placed. Each wind turbine involves a concrete pad of a specified dimension attached to the land and a fenced area of a specified dimension around the wind turbine. The associated infrastructure includes some buildings of a specified dimension that will house equipment associated with the wind turbines as well as some transmission cabling.
- The area of land on which the wind turbines and infrastructure are placed, as well as the fenced area around the wind turbines, is exclusively used by the Customer. Once placed, the Landowner cannot require the Customer to move any of the turbines or infrastructure during the term of the agreement.
- The rest of the plot continues to be available to the Landowner for agricultural purposes. The Customer is permitted to cross that land to access the wind turbines and associated infrastructure.

Issue 1: What is the identified asset(s) and does the Customer have the right to obtain substantially all the economic benefits from the use of that identified asset?

View 1A – The land that is exclusively used by the Customer is an identified asset and the Customer has the right to obtain substantially all the economic benefits from the use of that identified asset.

Proponents of this view think the area of land that is exclusively used by the Customer is physically distinct from the rest of the larger plot of land. In addition, because the Landowner cannot require the Customer to move its turbines or infrastructure once placed on the land, no substitution rights exist for this area of land. Therefore, they believe that the land that is exclusively used by the Customer is an identified asset.

In addition, the Customer obtains substantially all the benefits of that area of land as it has exclusive use for the period associated with the agreement. There is no additional use for that area of land once the wind turbines and associated infrastructure are installed throughout the remaining term of the agreement.

View 1B – The identified asset is the entire plot of land that is the subject of the agreement. The Customer does not have the right to obtain substantially all the economic benefits from the use of that identified asset.

Proponents of this view think the identified asset is the entire plot of land that is the subject of the agreement since the area occupied by the turbines and associated infrastructure are not considered to be physically distinct from the rest of the plot of land.

In addition, although the area occupied by the turbines and associated infrastructure is exclusively used by the Customer, the rest of the plot continues to be available to the Landowner for agricultural purposes. There are substantive economic benefits that can be derived from using the remaining land. As such, the Customer does not have the right to obtain substantially all the economic benefits from the use of the identified asset when the identified asset is the whole plot of land.

The Group's Discussion

Group members supported View 1A and noted that the areas of the land where the wind turbines and associated infrastructure are located are identifiable assets. Since the land exclusively assigned to the Customer cannot be used by the Landowner for any other purposes, Group members noted that the Customer has the right to obtain substantially all the economic benefits from the use of those identified assets. One Group member also noted that View 1A is consistent with the IFRIC [agenda decision](#) on the treatment of subsurface rights.

A few Group members observed that in practice determining the identified asset can be more complex in arrangements where the customer shares the use of an asset with other parties. Examples of such arrangements include advertising placed on the side of a building and an antenna installed on a cell tower. Another Group member commented that some arrangements may not have a physical fence but nonetheless contain contractual restrictions so that the Customer has the exclusive right to obtain substantially all the economic benefits from the use of the asset. Therefore, these Group members thought it was important for an entity to apply judgment and consider the facts and circumstances of the situation when making this assessment.

Issue 2: Assuming the arrangement is determined to contain a lease for the land that is exclusively used by the Customer, how should the payments be allocated between the lease and non-lease components?

Analysis

The Customer will apply paragraph 13 of IFRS 16 to allocate the consideration in the contract to each lease component based on the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components (see members' views of what the non-lease components would be in the Group's Discussion below).

An observable stand-alone selling price for the lease of those portions of the land that are used exclusively by the Customer may not be available. As such, the Customer would estimate the stand-alone price, maximizing the use of observable information.

When making the allocation, the Customer might assess that the price paid for exclusive land use would be higher than the price paid for shared land use. This implies a pro rata allocation based on land area may not be appropriate. The Customer might also recognize that it obtains only very limited use from the rest of the plot of land. Such considerations might suggest that substantially all of the payments in the agreement relate to the area of land exclusively used by the Customer.

However, the Customer should apply judgment to assess the specific facts and circumstances.

The Customer may apply paragraph 15 of IFRS 16 as a practical expedient, and not separate non-lease components from lease components and account for each lease component and any associated non-lease components as a single lease component. Since the entire contract consideration is allocated to the single lease component under this practical expedient, the initial and subsequent measurement of the lease liability and the right-of-use asset is higher than if the election was not applied.

The assessment of whether this arrangement contains multiple lease components rather than a single lease component has not been made. However, the resulting accounting may not be materially different.

The Group's discussion

Group members agreed with the analysis. They viewed the non-lease components as being the remaining areas shared with the Landowner since the lessee does not have exclusive use of these areas.

Some Group members noted that the use of the shared land and the economic substance of the transaction should be examined to understand the nature of the payment. In many cases, the payment is used to obtain exclusive use of the land. Therefore, these Group members thought that the lessee would either allocate substantially all the payments to the lease component or use the practical expedient to not separate the non-lease components from the lease components. However, in some circumstances, the shared space could have some value. For example, the Customer's right to cross the shared land to access the turbine could have value if the Landowner needs to reserve a large plot of land:

- a) for shared use with the Customer; and
- b) so that the Customer's equipment can access its turbine and related infrastructure.

In this case, some Group members thought that the lessee would need to allocate the payment to lease and non-lease components, absent use of the practical expedient not to do so.

Overall, Group members emphasized that the entity needs to apply judgment and consider the facts and circumstances to determine the identifiable assets and related non-lease components under IFRS 16. No further action on these issues was recommended to the AcSB.

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

IFRS 15, IFRS 16, IAS 2, and IAS 41: Impacts of IFRS 16 on Inventory Costing, Revenue Recognition, and Biological Assets

IFRS 16 *Leases* has resulted significant changes to lease accounting and several ancillary changes to other standards. The Group was asked to consider the impacts of IFRS 16 on the following:

1. inventory costing under IAS 2 *Inventories*;
2. measurement of the stage of progress using an input method for overtime revenue recognition under IFRS 15 *Revenue from Contracts with Customers*; and

3. costs capitalized in the transformation of biological assets under IAS 41 *Agriculture*.

Issue 1: How does IFRS 16 affect the allocation of overhead costs to inventory?

Under IFRS 16, the measurement of lease expense includes both the amortization of the right-of-use (ROU) asset and the interest expense. Prior to adopting IFRS 16, the allocation of overhead in the measurement of inventories included the total lease payments accounted for as operating leases for those lease arrangements used in the inventory production process.

Analysis

Paragraph 12 of IAS 2 requires that the costs of conversion of inventories include costs directly related to the units of production and a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Examples of fixed production overheads include depreciation and maintenance of factory buildings, equipment and ROU assets used in the production process.

Furthermore, paragraph 17 of IAS 2 states that IAS 23 *Borrowing Costs* identifies limited circumstances where borrowing costs are included in the cost of inventories. Paragraph 7 of IAS 23 states that inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets for capitalization of interest.

Therefore, with the adoption of IFRS 16, the overhead costs included in the cost of conversion would only include the amortization of the ROU asset and not the related interest expense for those lease arrangements used in the production process.

The Group's Discussion

Group members agreed with the analysis.

Issue 2: How does IFRS 16 affect the measurement of the stage of progress using an input method for overtime revenue recognition under IFRS 15?

Paragraph 39 of IFRS 15 states that for each performance obligation satisfied over time, an entity shall recognize revenue by measuring the progress towards complete satisfaction of that performance obligation. Input methods which are outlined in paragraphs B18 and B19 of IFRS 15 are a means of measuring such progress.

Under paragraph B18 of IFRS 15, revenue is recognized on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation. Paragraph B19 of IFRS 15 further states that an entity shall exclude from an input method the effect of any inputs that do not depict the entity's performance in transferring control of goods or services to the customer.

Analysis

Like Issue 1, with the adoption of IFRS 16, the total input costs and costs incurred to the satisfaction of a performance obligation would include the amortization of the ROU asset and not the related interest expense for those lease arrangements used in satisfying the performance obligation.

The Group's Discussion

Group members agreed with the analysis.

One Group member commented on the outcome of adopting IFRS 16 when compared with the superseded leasing standard- IAS 17, would result in measurement differences. For example, under the input method, the progress towards completion could be measured differently between IFRS 16 and IAS 17, even though the same leased asset is used to generate revenue. This Group member contemplated whether the input cost used to measure the progress of completion is a true depiction of how control is transferred to the customer. Another Group member commented that under IAS 17, for operating leases, the rent expense would be presented as one operating expense. IFRS 16 changes the accounting for operating leases by separating that single operating cost into interest and amortization expenses. This Group member thought that a change in the measurement of progress towards completion seems consistent with the overall changes to expense recognition under IFRS 16.

One Group member referred to paragraph B19 of IFRS 15 which states that “an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress... do not depict the entity’s performance in transferring control of goods or services to the customer.” This Group member noted that financing costs generally are not indicative of performance in transferring control to the customer and thought financing cost should generally be excluded from the input method.

Issue 3: How does IFRS 16 affect the costs capitalized in the transformation of biological assets?

The IFRS Interpretations Committee (“Committee”) issued an [agenda decision](#) in September 2019 on subsequent expenditures on biological assets. The Committee concluded that applying IAS 41, an entity can either capitalize subsequent expenditure or recognize it as an expense when incurred. In applying paragraph 13 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity would apply its accounting policy for subsequent expenditure consistently to each group of biological assets.

Analysis

If an entity adopts an accounting policy to capitalize the subsequent expenditure on biological assets and includes overheads in such costs, an issue similar to Issue 1 exists. The capitalized overheads would include the amortization of the ROU asset, not the related interest expense for those lease arrangements used in the biological transformation process.

The Group's Discussion

One Group member referred to the definition of a qualifying asset in IAS 23 *Borrowing Costs* and

noted that a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. For certain biological assets such as cannabis, the growing cycle is short and may not meet the definition of a qualifying asset. As a result, this Group member thought the interest cost associated with the lease agreements used in the biological transformation process may not be eligible to be capitalized to the carrying value of these types of biological assets with the adoption of IFRS 16.

Issue 4: What are the impacts on the opening balances of inventory, biological assets, or in-progress revenue earned when two IFRS 16 transition methods are applied?

A lessee applies IFRS 16 to its leases either:

- a. retrospectively to each prior reporting period presented applying IAS 8 (“full retrospective approach”); or
- b. retrospectively with the cumulative effect of initially applying IFRS 16 recognized at the date of initial application (“modified-retrospective” approach)

Analysis

As discussed in the above issues, applying IFRS 16 may result in a difference in the accounting for revenue recognized over time, inventories, and biological assets.

Since IFRS 16 allows entities a choice on transition, the transition approach the lessee adopts can result in differences on transition that apply to more than the underlying lease balances.

If the lessee applies the modified retrospective approach, the lessee will not restate the opening inventory, biological assets, or the progress of revenue earned. However, if the lessee chooses the full retrospective approach, then these amounts will be restated.

The Group’s Discussion

The Group agreed with the analysis.

One Group member observed that this issue is potentially applicable to other assets such as internally developed intangible assets and exploration and evaluation assets.

The purpose of the discussion is to raise awareness of the impact that IFRS 16 could have on other areas of accounting. No further action was recommended to the AcSB.

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

IAS 19 and IAS 34: Pension Remeasurement for Significant Market Fluctuations during an Interim Period

In February 2018, the IASB issued amendments to IAS 19 *Employee Benefits*. The amendments clarify that when a remeasurement is triggered by a plan amendment, curtailment or settlement during the period, an entity uses updated assumptions used in the remeasurement to determine current service cost and net interest for the remainder of the annual reporting period. These amendments are effective for annual reporting periods beginning on or after January 1, 2019.

The amendments did not address the effect of significant market fluctuations on the measurement of the current service cost and net interest in the annual financial statements. Paragraph BC173F of the Basis for Conclusions to IAS 19 states:

“The Board also considered whether it should address the accounting for ‘significant market fluctuations’, which are discussed in paragraph B9 of IAS 34. Plan amendments, curtailments or settlements generally result from management decisions and thus differ from significant market fluctuations, which occur independently of management decisions. The Board decided that the accounting for ‘significant market fluctuations’ is outside the scope of these amendments. Consequently, the amendments address only the measurement of current service cost and net interest for the period after a plan amendment, curtailment or settlement.”

However, paragraph B9 in the Illustrative Examples of IAS 34 *Interim Financial Reporting* states (emphasis added):

“Pension cost for an interim period is calculated on a year-to-date basis by using the actuarially determined pension cost rate at the end of the prior financial year, **adjusted for significant market fluctuations** since that time and for significant one-off events, such as plan amendments, curtailments and settlements.”

These two paragraphs raise questions as to whether there is a conflict between the 2018 amendments to IAS 19 and paragraph B9 of IAS 34. The Group considered the following fact pattern.

Fact Pattern

- Entity A prepares quarterly financial statements and is in the process of preparing its third-quarter interim financial statements (e.g., quarter ending September 30, 2019).
- During 2019 and leading up to the third quarter, there has been a significant decline in the discount rates and the entity has concluded that the decline is a significant market fluctuation since the prior year-end.

Issue 1: Should Entity A remeasure its net defined benefit liability in its interim financial statements?

View 1A – Yes.

Proponents of this view note that paragraph B9 in the Illustrative Examples of IAS 34 is clear that pension cost is adjusted for significant market fluctuations. A significant change in the long-term interest rate would qualify as a significant market fluctuation.

Since the 2018 amendments to IAS 19 did not change paragraph B9 in the Illustrative Examples of IAS 34, it would be appropriate to remeasure the net defined benefit liability for significant market fluctuations during the interim period. In accordance with paragraph 120(c) of IAS 19, the discount

rate would be updated to remeasure the liability and the remeasurement adjustment would be recognized in other comprehensive income.

View 1B – No.

Proponents of this view acknowledge that there appears to be a conflict between paragraph B9 in the Illustrative Examples of IAS 34 and the 2018 amendments to IAS 19. They also think that IAS 19 should be the standard that determines when remeasurement of a net defined benefit liability is required. Given that the amendments only require remeasurement when there is a plan amendment, curtailment or settlement, these are the only circumstances when a remeasurement should be performed during the year. Furthermore, they think that adjusting for significant market fluctuations in interim periods could be a significant burden on entities.

View 1C – An accounting policy choice exists.

Given IAS 19 is silent in this area, it would be permissible for an entity to adopt an accounting policy to not adjust for significant market fluctuations.

The Group's Discussion

Almost all Group members supported View 1A that, in this fact pattern, Entity A should remeasure its net defined benefit liability during the interim period based on paragraph B9 in the Illustrative Examples of IAS 34. They also pointed to paragraph BC173F of the Basis for Conclusions to IAS 19 as the 2018 amendments to IAS 19 only address plan amendments, curtailments or settlements, not the accounting for significant market fluctuations.

A Group member commented that there is no conflict between IAS 19 and IAS 34. Under IAS 19, an entity needs to determine the net defined benefit liability with sufficient regularity such that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period. Another Group member commented that in assessing whether a market fluctuation is significant, an entity needs to consider the impact of the change on the plan balances and not just the movement of the discount rate.

A few Group members noted that they have seen instances where an entity did not remeasure the net defined benefit liability, potentially due to materiality reasons. However, almost all Group members thought that based on existing guidance in IFRS Standards, an entity is required to remeasure its net defined benefit liability in its interim financial statements when there is a significant market fluctuation.

Issue 2: Assuming View 1A in Issue 1 applies, what discount rate should Entity A use to determine current service cost and net interest for the remainder of the year?

View 2A – Entity A should use the discount rate applied at the beginning of the year.

Proponents of this view note that paragraphs 28 to 29 of IAS 34 are clear that the same accounting policies should be applied in an entity's interim financial statements as are applied in its annual financial statements. However, the frequency of an entity's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes are made on a year-to-date basis.

Therefore, current service cost and net interest should be calculated using the discount rate that was applied at the beginning of the year regardless of the remeasurement due to a significant market fluctuation.

View 2B – Entity A should use the revised discount rate that was used to remeasure the net defined benefit liability.

Proponents of this view analogize to paragraph 123A of IAS 19 (newly introduced by the 2018 amendments to IAS 19) for remeasurements due to amendment, curtailment, and settlements. The paragraph indicates that after a remeasurement resulting from an amendment, curtailment and settlement, the net interest and current service cost for the remainder of the annual reporting period is based on the discount rate used to remeasure the net defined benefit liability. Proponents of this view also think that using a revised discount rate would provide more meaningful information to users.

View 2C – An accounting policy choice exists.

Proponents of this view believe there is no explicit guidance in IFRS Standards in this area, and as such, an accounting policy exists.

The Group's Discussion

Group members supported View 2A. An entity should use the discount rate applied at the beginning of the year to determine current service cost and net interest, even when it remeasures the net defined benefit liability due to a significant market fluctuation. A Group member pointed out that paragraph 123A of IAS 19 requires an entity to use the discount rate determined at the start of an annual reporting period to determine net interest, unless an entity remeasures the net defined benefit liability in accordance with paragraph 99 of IAS 19. However, paragraph 99 of IAS 19 only addresses plan amendments, curtailments or settlements and not significant market fluctuations. A few Group members also noted that market movements occur throughout the year. Therefore, it would seem overly burdensome for the standard to suggest that an entity is required to use revised discount rates to compute the current service cost and net interest whenever significant market movements occur.

While Group members supported View 2A, a few Group members acknowledged that it would be difficult to preclude View 2B (i.e., use a revised discount rate to determine current service cost and net interest). These Group members thought entities applying View 2B should adopt an accounting policy and not reset the discount rate only for selected events. That said, Group members noted that based on existing guidance in IFRS Standards, entities are not required to reset the discount rate until the beginning of the following annual reporting period in determining current service cost and net interest absent a plan amendment, curtailment or settlement.

Overall, the Group's discussion raises awareness about pension remeasurement for significant market fluctuations during an interim period. 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 12: Deferred Taxes on Goodwill in a Business Combination

Many taxation authorities do not allow a reduction in the carrying amount of goodwill as a deductible expense in determining taxable benefit. Moreover, the cost of goodwill is often not tax-deductible when a subsidiary disposes of its underlying business. In these circumstances, goodwill has a tax base of nil dollars. However, paragraph 21 of IAS 12 *Income Taxes* does not permit the recognition of a deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

When goodwill is tax-deductible in a particular jurisdiction, and such tax-deductible goodwill is acquired in a business combination, it is necessary to compare the tax base of the goodwill arising from the business combination to its carrying amount. When the carrying amount of an asset is less than its tax base, the difference will give rise to a deferred tax asset. This deferred tax asset arising from the initial recognition of goodwill is recognized as part of the accounting for a business combination to the extent that it is probable that taxable profit will be available against which the deductible temporary difference could be utilized.

The Group was asked to consider a scenario where an entity with tax-deductible goodwill is acquired by another entity in a business combination. The Group discussed the accounting for the deferred tax on the goodwill in this business combination.

Fact Pattern

- Entity A acquires 100 per cent of Entity B's shares in a transaction that meets the definition of a business combination as defined in IFRS 3 *Business Combinations* ("Acquisition 1"). Entity A recognizes \$5 million as the goodwill arising from this acquisition based on acquisition accounting.
- At the date of acquisition, Entity B has goodwill in the amount of \$1 million on its balance sheet resulting from multiple previous business combinations. This "pre-existing goodwill" is deductible for tax purposes over several years and has a tax base of \$1 million at the date of Entity A's acquisition of Entity B.
- For both Entity A and Entity B, it is probable that taxable profit will be available against which any deductible temporary difference could be utilized.

Issue: How should the temporary difference (if any related to the goodwill arising in the acquisition be determined?

View A – The carrying amount of the goodwill arising on Acquisition 1 of \$5 million should be compared to the tax base of Entity B's pre-existing goodwill of \$1 million.

Proponents of this view think that because goodwill is measured as a residual for accounting purposes, its sources are generally not identifiable. Therefore, they argue that the goodwill arising on the acquisition of Entity B is indistinguishable from Entity B's pre-existing goodwill.

In this case, a taxable temporary difference of \$4,000,000 (\$5,000,000 - \$1,000,000) exists. However, no deferred tax liability is recognized, initially or subsequently, due to the requirements of paragraph 21 of IAS 12 which do not permit the recognition of a deferred tax liability related to

goodwill acquired in a business combination. As a tax deduction for Entity B's pre-existing goodwill is taken every year, a new taxable temporary difference is created, and a related deferred tax liability is recognized.

View B– The carrying amount of the goodwill arising on Acquisition 1 should be compared to its tax base of nil dollars. The carrying amount of the pre-existing goodwill of the acquired entity of nil dollars is compared to its \$1 million tax base.

Proponents of this view think that no link exists between the goodwill arising on the acquisition and the pre-existing goodwill of the acquired entity.

In this case, the carrying amount of the goodwill arising on the acquisition is compared to its nil-dollar tax base, resulting in a taxable temporary difference of \$5 million. No deferred tax liability would be recognized, initially or subsequently, for this taxable temporary difference for the same reasons as outlined in View A above. In addition, the carrying amount of the pre-existing goodwill of the acquired entity of nil dollars should be compared to its tax base of \$1 million resulting in a deductible temporary difference of \$1 million. Given that it is probable that taxable profit will be available against which the deductible temporary difference could be utilized, a deferred tax asset should be recognized.

View C – Entity A must determine whether the goodwill recognized on Acquisition 1 is linked to the pre-existing goodwill before determining the amount of any temporary difference. To make this determination, Entity A would consider the facts and circumstances that gave rise to the goodwill previously recognized by Entity B.

Proponents of this view think that an assessment should be made on a case-by-case basis as to whether goodwill recognized on acquisition of another entity arises from the same factors that gave rise to the goodwill previously recognized by the acquiree. In cases where new goodwill is related to or linked to previous goodwill, View A should apply. In cases where new goodwill is not linked to previous goodwill, View B should apply.

Some examples of factors an entity should consider when assessing whether the new goodwill is linked to previously recognized goodwill may include:

1. Whether the goodwill relates to an acquisition of an entity in an industry different from the acquiree and the acquiree's primary businesses.
2. The timing of the acquisition that gave rise to the existing goodwill of the acquiree and the proximity to the current acquisition and whether the initial acquisition transaction was completed in anticipation of the second acquisition transaction.

The Group's Discussion

Several Group members noted that the first step before calculating the deferred taxes on goodwill is to verify that the tax pool in question is related to goodwill. Some Group members observed that in practice, the tax pool is often related to intangible assets rather than goodwill. Therefore, it may be important to consult with tax professionals to confirm the nature of the tax pool.

Most Group members preferred View C. They considered the process of separating the previous existing goodwill, examining individual circumstances that gave rise to the goodwill, and assessing whether a link exists with the new goodwill to be most robust. Therefore, this process would result in a more precise deferred taxes amount.

While supporting View C conceptually, several Group members acknowledged that View A (i.e. the carrying amount of the new goodwill is compared to the tax base of the existing goodwill) often cannot be excluded in practice. These members thought that depending on the length of time between the previous acquisitions and the most recent acquisition it might be difficult for an entity to differentiate the previously recognized goodwill from the goodwill recognized in the most recent acquisition. Some Group members also preferred View A. They considered goodwill a residual amount for accounting purposes and its sources to be generally not identifiable. Therefore, these members thought that the origin of the different goodwill amounts is indistinguishable.

One Group member also thought that all three views could be accepted given the lack of specific guidance provided in IAS 12 in this area.

The purpose of the discussion is to raise awareness on different approaches to account for the deferred taxes on the goodwill in a business combination. No further action was recommended to the AcSB.

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

IAS 36: Climate Change and Asset Impairment

Investors are increasingly seeking information on how entities are addressing environmental risks and about the economic and social impact of such risks on their operations. On November 28, 2019, an [article](#) was published on the IASB's website explaining how the principles-based approach to IFRS covers emerging risks, such as those related to climate change.

With increased focus on emerging risks such as those related to climate change, entities should assess the impact of climate change on their financial statements and other reporting obligations.

The Group considered the following accounting considerations related to climate change.

Accounting considerations related to climate change

Useful life of assets

The requirement for an entity to review an asset's useful life at least at each financial year-end is contained in paragraph 51 of IAS 16 *Property, Plant and Equipment*. A similar requirement exists for re-assessing of the useful life of intangible assets under paragraph 104 of IAS 38 *Intangible Assets*.

An entity should consider the impact of climate change when assessing whether an asset's useful life has changed.

When external factors indicate that an asset may become physically unavailable or commercially obsolete earlier than expected, this should be factored into reviewing the asset's useful life. For example, the shift from diesel to electric cars may result in the reassessment of the diesel cars useful life. Since assets are depreciated over their useful life, a shorter useful life may result an increased depreciation expense being recognized over the shorter useful life of the asset.

Impairment of non-financial assets

When an indicator of asset impairment exists, an entity is required to estimate the recoverable amount of the asset or the cash-generating unit (CGU) to which the indicator relates. The recoverable amount is the higher of its fair value less costs of disposal (FVLCD) and value in use (VIU). FVLCD is a 'market' fair value. Market prices typically reflect the market's view on how climate change may affect the non-financial assets. As a result, entities should ensure that FVLCD reflects the impact of climate change.

Cash flow projections used in VIU calculations should be based on reasonable and supportable assumptions that represent management's best estimate of those factors. Judgment is required to determine when and how climate change and related risks should be reflected in cash flow projections. Generally, the effects of changes outside management's control should be included in the VIU calculation when they form part of management's forecasts based on reasonable and supportable assumptions.

Incorporation of expected changes in behaviour

Changes in consumer behavior may affect entities in certain industries. Forecasted changes in consumer behaviour expected to result in positive or negative changes in either the volume or price of future sales should be reflected in the VIU assessment.

Similarly, expected changes in the behaviour of an entity's suppliers or business customers, who themselves may have to react to climate change, may result in changes to an entity's cost or revenue base.

Incorporation of expected government actions

Changes in government policy or legislation may also affect the future cash flows that will be generated by an asset or a CGU. While the exact nature or form of the government action may not be certain, if in management's best estimate there will be an effect on the entity's cash flows, then the expected changes in cash flows should be included in the recoverable amount.

Incorporation of changes expected to occur beyond the period covered by financial budgets and forecasts of expected government actions

Paragraph 33(c) of IAS 36 *Impairment of Assets* requires cash flow projections in VIU calculations, beyond the period covered by the most recent budgets/forecasts, to be extrapolated using a steady or declining growth rate. The extrapolated cash flows should reflect the anticipated timing and magnitude of the effect of climate change. If a single terminal growth rate is applied in the

recoverable amount calculation, then the termination growth rate should be adjusted to reflect the impact of climate change.

Incorporation of changes in operations and structure

When the recoverable amount is measured as VIU, paragraph 44 of IAS 36 requires future cash flows to reflect the asset or CGU in its current condition and the cash flow projections should not generally include the effects of changes in scope or manner of operations, if such changes are material. Determining the magnitude of change in the process and output of the asset or CGU requires judgment. For example, if in management's view, the action is a refinement rather than a major change of the manufacturing process, the cost of modifying the manufacturing process is included in the VIU calculation.

In addition, entities may need to undertake capital expenditures to evolve their business in response to climate change. Entities will need to assess which expenditures should be incorporated in their recoverable amount calculation (i.e., whether the expenditure represents a part of the cost of maintaining the asset or the CGU in its current condition).

New transactions and events

Climate change may have an impact on provisions and contingent liabilities arising from changes in environmental laws, or as a result of new or expanded remediation obligations that may arise from new or amendments to contractual arrangements. In addition, depending on the accounting policy selected and the structure of certain emission trading schemes, an entity may recognize an asset for emission credits.

As data relating to the effect of climate change also becomes more observable, an entity should consider how those risks may affect the valuation of its investments.

Disclosure related to climate change

Entities should assess the significance of climate change and related risks to the financial statements. For example, when climate change and related risks play a significant role in determining the recoverable amount of an asset or a CGU, the key assumptions applied and a description of management's approach to arrive at these key assumptions should be disclosed. Entities should also consider disclosures related to estimation uncertainty as it relates to climate change.

Corporate reporting implications

In August 2019, the Canadian Securities Administrators issued [CSA Staff Notice 51-358 Reporting of Climate Change-related Risks](#) ("SN 51-358"). SN 51-358 provides guidance on how an issuer might approach identifying, preparing, and providing disclosures of material risks climate change poses. As noted in the [CPA Canada publication *Disclosing the impact of climate change: A process for assessing materiality*](#), the definition of material may vary based on the framework under which it is being assessed (i.e. under securities law versus IFRS or whether reporting is done outside of a continuous disclosure document). Management should ensure that there is consistency between the climate change disclosures made in its various reporting documents.

The Group's Discussion

Group members agreed that risks associated with climate change are important factors for entities to consider when performing their long-lived asset impairment assessments. Several Group members observed that climate change is one factor among a set of other broader environmental, social, and governance (ESG) and technological factors. Therefore, it is important for entities to have a comprehensive understanding of their business risks when performing the impairment assessment. For example, a change in labour practices or a disruption in technology could lead to asset impairment. One Group member commented that asset impairments are as a result of specific facts and circumstances but the related disclosure in the financial statements are often very generic. Therefore, entities should consider disclosing in their financial statements the relevant entity-specific factors they considered when performing their impairment assessment.

The Group then discussed other reporting tools entities use to communicate their ESG results. A representative of the Canadian Securities Administrators commented that the Management Discussion and Analysis (“MD&A”) and Annual Information Form (“AIF”)³ are useful documents for entities to discuss their risk assessment process and communicate the impact that these risks have on financial performance of the company. In addition, SN 51-358 is intended to assist entities, including boards and management, to identify material climate change-related risks and to improve their disclosure of such risks, including their impact on the overall business, as part of their corporate reporting. A few Group members noted that in addition to the MD&A and the AIF, some entities use special frameworks to issue a stand-alone report on ESG. They highlighted the importance of having a robust governance process to ensure the message provided in the ESG report is consistent with other documents available to the public.

Some Group members observed that information on ESG risks is especially important to investors with a long-term investment horizon. The financial statements do not necessarily provide enough information to assess an entity's performance in managing ESG risks. These Group members hoped that the ESG reporting will continue to evolve to help financial statement users better assess an entity's performance and make more informed investment decisions.

The purpose of the discussion is to raise awareness of how climate change affects financial reporting. No further action was recommended to the AcSB.

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

IAS 32: Classification of Limited Partnership Units

The Group was asked to consider a limited life partnership structure where the general partner (GP) receives management and performance fees. The Group discussed whether these fees should be treated as a separate unit of account when evaluating the conditions in paragraphs 16A-16D of IAS 32 *Financial Instruments: Presentation* and whether the structure of the arrangement matters in the assessment.

³ Annual information form is a document required to be filed annually with Canadian securities commissions by public companies and investment funds in Canada. It contains prescribed information about the issuer and its securities.

Fact Pattern

- The Fund, incorporated as a limited partnership, is a close-ended fund with a predetermined maturity (end-of-life) of eight years from its incorporation. In this fact pattern, assume that maturity may be extended if approved by unitholders.
- The Fund has issued two categories of units:
 - One Management unit subscribed by the GP; and
 - Ordinary Units subscribed by the Limited Unitholders/partners (LP)
- The following terms are included in the Fund's partnership agreement and articles:
 - In the event of dissolution, the net assets shall be distributed to the unitholders (which includes GP and LP unitholders) pro rata to the number of units they held.
 - The GP is entitled to a management fee equal to 1 per cent per annum of the Fund's net asset value.
 - The GP is also entitled to a performance fee, which is based on the change in the Fund's net assets. Once the Fund achieves an 8 per cent hurdle rate⁴, then any performance surplus is distributed to the unitholders and the GP. Once the GP receives a performance fee of 10 per cent of the surplus return any additional return is split pro rata among the Management unit and ordinary units.
- Under local legislation, the GP has unlimited liability for any of the Fund's obligations that cannot be settled using the Fund's asset.

Paragraphs 16C and 16D of IAS 32 provide an exception to an instrument that meets the definition of a financial liability to be classified as an equity instrument. To qualify for this exception, the instrument must impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation. The units in the Fund have such attributes. Therefore, they may only be presented as equity in the Fund if they meet the criteria in paragraphs 16C and 16D of IAS 32.

Under paragraph AG14F of IAS 32, for analyzing the conditions in paragraphs 16A-16D of IAS 32, only the cash flows and contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered. Therefore, for purposes of applying paragraphs 16A-16D of IAS 32, the Group focused on determining whether the GP's management and performance fees should be viewed as part of the overall returns of the GP as an owner, rather than arriving at a classification conclusion.

Issue 1: Are the GP's management and performance fees a unit of account separate from the Management unit for the purpose of the analysis?

⁴ A hurdle rate represents the minimum rate of return the GP should generate before earning the additional return.

View 1A – GP’s management and performance fees are a separate unit of account and should be viewed as remuneration for management services in its capacity as a non-owner.

Proponents of this view think it is clear from the arrangement that the GP is being remunerated for its management services in the form of management and performance fees. They refer to paragraph AG14I of IAS 32 and think that the GP is acting in a capacity as a non-owner in performing the management service. This is because the LPs would not have agreed to the arrangement if the arrangement was not at similar terms to an equivalent transaction between a third-party non-owner manager and the Fund.

Therefore, the proponents of this view think GP’s management and performance fees should be considered as a separate unit of account from the Management unit and should be viewed as remuneration for management services in GP’s capacity as a non-owner.

View 1B – GP’s management and performance fees are not a separate unit of account and should be viewed as part of the overall returns in its capacity as an owner.

Proponents of this view think that it is generally impracticable to identify an equivalent transaction between a third-party non-owner manager and a Fund in which the management and performance fees have similar terms, cash flows, and conditions because each arrangement is unique.

They further consider the criteria in paragraph 16D of IAS 32 that require other instruments to “have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the investment as an equity instrument.” They think that the same approach can be applied to GP’s management services, since an equivalent transaction is impractical to be identified for comparison, and therefore the management and performance fees will not be considered a separate arrangement.

The Group’s Discussion

Group members offered diverse views on this issue.

One Group member noted that paragraphs 16C and 16D of IAS 32 are exceptions to the classification requirements for financial liabilities in IAS 32. Without these explicit exceptions, units that must be redeemed in cash after a certain period or based on events outside the issuers’ control would be classified as liabilities. This Group member expressed the view that such exceptions should be applied literally and rather narrowly. Thus, this Group member supported View 1B to not separate the GP’s management and performance fees from the GP’s Management unit for purposes of considering whether the units can be classified as equity.

Several Group members observed that some entities have applied View 1A to treat GP’s management and performance fees as a separate unit of account from the Management unit, and view the fees as compensation for the GP’s service. They thought that the management fee element is evident in the management unit arrangement. One Group member observed that in practice the GP’s Management units are often created for legal purposes only. As such, the substance of the management and performance fees are to compensate the GP for its service, not to generate variable returns for the GP in its capacity as an owner.

Other Group members thought that the classification of the Management units is dependent on the facts and circumstances of the arrangement. The Group members referred to guidance in paragraphs AG14F to AG14I of IAS 32 that helps distinguish whether the transaction with the instrument holder is in the instrument holder's capacity as an owner or as a non-owner. To qualify as a non-owner, the management and performance fees paid to the GP must be similar to an equivalent transaction that might occur between another non-related manager and the Fund. These Group members observed that in practice, identifying the equivalent transaction can be difficult considering each management arrangement is unique. They emphasized the need to apply judgment to individual facts and circumstances to reach a conclusion. Some points to consider in making that judgment might include:

- whether the performance fees offered to the GP are equivalent to the compensation paid to an independent manager;
- whether an investment is required by the GP to earn the performance fees that is not required by another management company; and
- whether the GP has a priority to receive the service and performance fees over other unitholders' rights to returns on their investment.

Issue 2: For the purposes of the unit of account assessment, does it matter how the arrangement is structured?

View 2A – The form of the arrangement (e.g., through units or allocated based on capital contributed) is not a relevant factor in the unit of account assessment.

Since IAS 32 lacks specific guidance in this area, proponents of this view think the substance of the arrangement needs to be examined. The entity should apply judgment to determine whether multiple contracts or transactions arising from a single legal contract between the parties represent single or multiple instruments. When making such an assessment, the entity may consider, among other factors, whether the pricing of individual transactions is independent and whether the transactions have different commercial objectives.

Moreover, proponents of this view think that whether the units may be issued to the parties is not relevant in assessing the unit of account. The partnership agreement generally defines the method by which the capital of the Fund is distributed with pro rata distribution based on ownership interests (after management and performance fees are deducted) so that the substance of the arrangement would not change even when no units are issued.

View 2B – The form of the arrangement (e.g., through units or allocated based on capital contributed) is a relevant factor in the unit of account assessment.

Proponents of this view consider that an entity cannot ignore the way the arrangement with the parties is structured. The agreement may only define how returns are allocated to the parties based on a waterfall structure. Therefore, it may not be reasonable to separate an element from the overall waterfall structure for the purposes of the assessment. As such, the agreement may be a profit-sharing agreement.

They also think that to meet the criterion in paragraph 16C(a) of IAS 32, units need to be issued to

the parties so that the allocation of returns is based on the number of units each party holds.

The Group's Discussion

The Group expressed diverse views on this issue.

Some Group members prioritized the substance over the form of the arrangements and supported View 2A. These Group members observed that in practice, the services fees are sometimes included in a separate agreement from the Fund's main documents. Therefore, considering the complexity in assessing the unit of account, they thought the entity should take a holistic approach to examine all relevant documents to understand the arrangement and the services being provided, and how the GP is compensated.

Other Group members supported View 2B. The fund could be structured in many ways to serve various purposes such as legal protection and tax planning. Therefore, they thought it was important to consider the form of the arrangement and understand why the arrangement was structured as it was to ensure the appropriate IFRS Standard is used to account for such transaction.

The purpose of the discussion is to raise awareness of the application issue of assessing the proper unit of account to apply exceptions in paragraphs 16C and 16D of IAS 32. No further action was recommended to the AcSB.

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

IAS 19: Long-term Bonus Plans Contingent on Future Events or Performance

IAS 19 *Employee Benefits* distinguishes between short-term employee benefits and other long-term employee benefits. The distinction is based on whether such benefits are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related services.

Meanwhile, although long-term employee benefits can share many of the same features of short-term benefits, IAS 19 requires long-term employee benefits to be accounted for in the same way as defined benefit pension arrangements. The exception is that long-term employee benefit remeasurements are recognized immediately through profit or loss rather than in other comprehensive income.

Some bonuses in a plan may be contingent on the occurrence of an uncertain future event (e.g., initial public offering or sale of the business) or on achieving a specified performance target like earnings per share (EPS). The bonus amount may also vary depending on the amount of consideration received from the occurrence of the uncertain future event or the level of the performance target achieved.

The Group considered the following fact pattern and discussed how to incorporate contingencies for uncertain future events into the recognition and measurement of long-term bonus plans.

Fact Pattern

- Entity A establishes a long-term incentive plan at the beginning of 20X0 for senior management. Senior management of Entity A will be awarded with a bonus compensation of 10 per cent of

their base salary, payable immediately upon achievement of the target EPS growth. The target is a one-year growth in EPS of 5 per cent, calculated based on the first day of 20X0 to the end of 20X1.

- For each 1 per cent of EPS growth achieved above 5 per cent, an additional 1 per cent will be added to senior management's 10 per cent base salary as bonus compensation.
- Entity A has a historical EPS trend of negative 2 per cent, positive 3 per cent and positive 8 per cent for the preceding three years, prior to 20X0.

Issue 1: Should the probability of an event or achievement of a performance target occurring affect the recognition of a liability for the long-term incentive plan?

View 1A – No.

Paragraph 72 of IAS 19 states in part, “the probability that the specified event will occur affects the measurement of the obligation but does not determine whether the obligation exists.” Therefore, proponents of this view consider that IAS 19 requires recognition of an obligation for long-term employee benefits when services are rendered.

The period during which the services rendered in connection with the long-term employee benefit commenced in 20X0 and there is a present obligation by Entity A arising from past events that will be settled through the payment of bonus compensation. Therefore, uncertainties such as the probability of occurrence should only be considered in the measurement of the liability.

View 1B – Yes.

Under the current *Conceptual Framework for Financial Reporting* (not the revised *Conceptual Framework* that is effective for annual periods beginning on or after January 1, 2020), a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Based on the above definition, proponents of this view note that if it is deemed unlikely that Entity A will achieve the EPS growth of 5 per cent or greater during the relevant term, no liability should be recognized during the period for which the services are rendered.

The Group's Discussion

Group members supported View 1A that the probability of an event or achievement of a performance target does not affect the recognition of a liability for the long-term incentive plan. A plan is offered to employees in return for their service and, therefore, a liability exists. Probability of event occurrence affects the measurement of the liability, not its existence.

Issue 2: Assuming View 1A applies, how should the liability for the long-term incentive plan be measured?

IAS 19 does not provide guidance on how the measurement of the liability should be adjusted to account for contingencies based on the occurrence of an uncertain future event. Specifically, the standard does not address how an entity might determine the probability of the uncertainty occurring

or not occurring.

IFRIC 23 *Uncertainty over Income Tax Treatments* includes measurement guidance of tax uncertainties such that an entity reflects the effect of a tax uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. An entity reflects the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which method the entity expects to better predict the resolution of the uncertainty:

- (a) The expected value method – the sum of the probability-weighted amounts in a range of possible amounts.
- (b) The most likely amount method – the single most likely amount in a range of possible amounts

The Group discussed the following views on whether the approaches described under IFRIC 23 are acceptable approaches for incorporating contingencies based on the occurrence of an uncertain future event into the measurement of the long-term employee benefit liability.

View 2A – The liability for the long-term incentive plan should be measured based on the expected value method. This approach may be appropriate when there are a number of possible outcomes.

Proponents of this view consider that IFRIC 23 can be applied by analogy since there is a range of possible outcomes that would affect the amount of the liability. Therefore, the estimate should consider the probability of the alternatives.

Under this view, the liability would be calculated by ascribing a weighted probability to each of the outcomes, including non-achievement of the target EPS growth, achievement of 5 per cent EPS growth and each incremental percentage in excess of 5 per cent.

View 2B – The liability for the long-term incentive plan should be measured based on the most likely amount method. This approach may be appropriate when there are only two possible outcomes.

Proponents of this view also consider analogizing to IFRIC 23. However, despite the fact there are a range of possible outcomes that affect the amount of the liability, there may be one outcome that is most likely based on historical performance and future predictions of performance.

Each of the outcomes would be assigned a probability, including non-achievement of the target EPS growth, achievement of 5 per cent EPS growth and each incremental percentage in excess of 5 per cent. The outcome that is most likely would be used to calculate the liability.

The Group's Discussion

Group members supported using the approaches described under IFRIC 23 for incorporating contingencies based on the occurrence of an uncertain future event into the measurement of the long-term employee benefit liability. Specifically, paragraph 76 of IAS 19 states in part (emphasis added), "Actuarial assumptions are an entity's **best estimates** of the variables that will determine the ultimate cost of providing post-employment benefits." This concept of best estimates is aligned with both the expected value method and the most likely amount method. These Group members also thought that based on facts and circumstances, the method that results in the best estimate should be used, based on the range of possible outcomes.

Group members noted that in applying the most likely amount method, the results could lead to recognizing an amount that is measured at zero. For example, in a binary-type scenario when the outcome is either all or nothing, the amount may be measured at zero if circumstances where the probable outcome is nothing. However, the probability of the one outcome that is most likely to occur may change over time. Therefore, even though in one reporting period, the amount may be zero, entities still need to perform ongoing assessments to determine if the measurement of the amount has changed. This concept is consistent with the actuarial method in IAS 19 that requires periodic adjustment. A Group member also pointed out that investors would want entities to disclose their estimation process and whether the amount could change significantly over time.

Another Group member noted that a most likely amount method may also be appropriate in more than just a binary-type scenario. For example, this Group member noted there could be three or four outcomes but within that set of outcomes, one outcome is much more likely than the others. In that scenario, an entity may still use the most likely amount method instead of the expected value method (i.e., weighted probability) to determine its best estimate. That said, Group members highlighted that selecting the measurement method to use depends on facts and circumstances.

Group members also briefly discussed how IAS 19 is different compared to other standards like IFRS 2 *Share-based Payments* and IFRS 3 *Business Combinations*. IAS 19 applies an actuarial method based on expectations in determining management's best estimate to measure the liability. On the other hand, IFRS 2 applies an expected to vest concept when determining recognition for transactions with non-market performance conditions within the scope of that standard. IFRS 3 requires measurement based on a fair value concept, which is not the same as the best estimates concept in IAS 19.

Overall, the Group discussed these issues to raise awareness about the factors to consider in recognizing and measuring long-term bonus plans that are contingent on future events or performance. No further action was recommended to the AcSB.

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

International Accounting Standards Board's 2020 Agenda Consultation

The IASB is required to undertake a public consultation on its work plan every five years. The primary objective of the agenda consultation is to seek formal public input on the strategic direction and balance of the IASB's work plan. The 2020 Agenda Consultation project was initiated in September 2019 with the IASB planning to publish a Request for Information (RFI) in the second half of 2020.

Prior to the meeting, the AcSB staff gathered initial feedback from the Group for its suggestions on potential future topics to be included in the agenda consultation.

At the meeting, the AcSB staff presented the following topics from the initial feedback from the Group:

- (1) Intangible assets– recognition of, or disclosure for, intangible assets not currently recognized in IAS 38 *Intangible Assets***

IAS 38 needs to be modernized to provide information about unrecognized internally generated intangible assets such as human capital, organizational capital and, relationship capital.

IAS 38 currently does not:

- permit the recognition or measurement of certain internally generated intangible assets; or
- require disclosure about an entity's unrecognized internally generated intangible assets or value creation activities;

This topic is important as an entity's value creation activities are increasingly more intangible in nature.

(2) Biological assets– finding the appropriate measurement basis

IAS 41 *Agriculture* should be reviewed to determine whether fair value less costs to sell is the only appropriate measurement basis when biological assets are not yet harvestable and are not typically sold in their current condition.

The current standard may not provide users with the most relevant and reliable information about immature biological assets and the related future cash flows.

(3) Employee benefits– lack of accounting guidance for other types of pension plans

New types of pension plans that are neither defined contribution plans nor defined benefit plans (i.e., hybrid pension plans), are becoming more prevalent in multiple jurisdictions. The current accounting guidance in this area is designed for traditional defined contribution plans and traditional defined benefit plans.

The development of further guidance on accounting for hybrid pension plans to better reflect their economic characteristics and to reduce diversity in practice should be seen as important. Doing so would ensure the usefulness of information provided to financial statement users and limit the reporting problems that could be caused under current guidance which lacks specificity in this area.

(4) Cryptocurrency assets– requiring the remeasurement to fair value through profit/loss

Under the current IAS 38 cost model, the most useful information on cryptocurrencies (i.e. fair value) is not provided to users of financial statements.

The use of cryptocurrencies or similar types of assets is increasing. This topic, along with the development of guidance to account for these or similar instruments, was broadly considered to be a topic the IASB should consider adding to its next agenda.

The Group continued its discussion on these initial topics and raised additional topics to consider for potential inclusion in the IASB's 2020 Agenda Consultation.

The Group's Discussion

Group members thought that the initial topics gathered from the Group are relevant in Canada. They

further commented on the following topics:

- **Biological assets:** Some Group members questioned whether the problem with IAS 41 is that the current measurement basis is not suitable for biological assets with a shorter growth cycle. For companies in the cannabis industry, they thought that applying fair value less cost to sell to crops that are not typically sold in their current form does not provide users with reliable information about the entity's performance. They also thought that remeasuring biological assets at fair value less cost to sell creates profit and loss volatility across reporting periods and that these issues are exacerbated by the quarterly financial reporting requirements in Canada. A representative from the Canadian Securities Administrator commented that one potential solution is to have an accounting policy choice where the entity can elect to measure the biological asset using either fair value less cost to sell or a cost-based approach with fair value information disclosed. Another Group member thought that a solution may be to include a practical expedient in the standard to measure agriculture products with a growth cycle of less than 12 months at cost.
- **Recognition of certain internally generated intangible assets:** One Group member reflected on the complexity of the existing goodwill impairment test and questioned whether including more internally generated intangible assets on the balance sheet would increase this complexity. The AcSB Chair commented that the rationale for considering this topic is to improve the relevance and usefulness of financial statements to users. In considering the financial statements of public companies, it is evident that a significant portion of their value is attributable to intangible assets not recognized on the balance sheet. As a result, users are obtaining this information elsewhere. This difference between a company's book value and its market value ascribed by the users may result in the financial statements losing relevance. By undertaking this project, the IASB could narrow this difference to better reflect an investor's view of the value in a company.

Group members also raised the following topics to consider for inclusion in the IASB's 2020 Agenda Consultation:

- **Reconsidering push-down accounting:** Several Group members thought this topic was relevant and important given companies have recently adopted new standards such as IFRS 16 and IFRS 9. One Group member used the adoption of IFRS 16 as an example to illustrate their concern. In the scenario described, two entities independently adopted IFRS 16 and made transition elections at adoption date. When one entity acquired the other entity, the consolidated accounting for the subsidiary entity's leases is different from its accounting for its leases. Without applying push-down accounting, consolidation adjustments could exist for many years.
- **Impact of climate change:** Group members thought this topic was important for the IASB to consider as a potential project given the worldwide climate change movement. Some Group members thought the IASB could improve the financial reporting framework to better reflect the broader effects entities have on the environment and society. One Group member commented that financial statements could be improved to reflect the costs entities impose on the environment in its liabilities. Another Group member thought the IASB could develop disclosure

requirements on climate change. Other Group members noted that, while this disclosure is important, it may not fit well in the audited financial statements. Other reporting documents may be more appropriate for such disclosure.

- Group members raised other topics, including updating IAS 33 *Earnings Per Share*, IAS 7 *Statement of Cash Flows*, IAS 12 *Income Taxes*, and further standard setting on cloud computing.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IFRS 16: Right to Control Assessment

At the June 2019 meeting, the Group recommended the AcSB (Board) consider referring this issue to the IASB or the IFRS Interpretations Committee. The AcSB directed staff to undertake further research to understand how pervasive the issue is across different industries in Canada.

At the October 2019 meeting, the AcSB considered the results of targeted outreach, which focused on whether it is common for a lessor to provide a lessee the first refusal right to purchase the remaining capacity of a leased asset. The Board understands that this is common in the oil and gas industry; however, it noted that this issue was not widespread among other industries. This issue would not meet the IFRS Interpretations Committee's agenda criteria. Therefore, the Board decided not to raise it with the IFRS Interpretations Committee. The Board directed staff to continue monitoring future developments in IFRS 16 *Leases*, specifically in the oil and gas industry, to assess whether this issue should be raised in the future (such as during the post-implementation review of IFRS 16).

IFRS 3, IAS 12, and IFRIC 23: Uncertain Tax Position Acquired in a Business Combination

At the June 2019 meeting, the Group recommended the AcSB to consider referring the issue of whether the exception described in paragraph 24 of IFRS 3 could be revised to include both current and deferred tax assets or liabilities to the IASB or the IFRS Interpretations Committee.

The AcSB continued its discussion at its December 2019 meeting. The Board received an update on activities to date and noted that the IASB has discussed this issue at its December meeting and has tentatively decided not to add an exception in IFRS 3 for current tax assets and liabilities within the scope of IFRIC 23 *Uncertainty over Income Tax Treatments*. The Board directed staff to continue monitoring future IASB discussions on this topic and update the Board at a future meeting.

IFRS 16: Sale-leaseback Transaction with Variable Payments

At the September 2019 meeting, the Group recommended the AcSB consider referring the issue of how to measure and present the liability related to fixed and variable lease payments in the financial statements to the IASB or the IFRS Interpretations Committee.

Subsequent to the meeting, the IFRS Interpretations Committee received a submission of a similar fact pattern and discussed this issue at its November meeting. It will continue discussing this issue at future meetings.

The AcSB discussed the Group's recommendation and updates in its December meeting and directed staff to continue monitoring future developments on this topic and provide an update to the Board on the decision reached by the Committee at a future meeting.

IFRS 16 and IAS37: Variable Lease Payments and Onerous Lease Provisions

At the September 2019 meeting, the Group recommended the AcSB to consider referring the issue of whether an onerous provision should be recognized for any variable payments not recognized in the lease liability either to the IASB or to the IFRS Interpretations Committee.

The AcSB discussed Group's recommendation at its December meeting and directed staff to gather additional information on this issue which will be discussed at a Board meeting in early 2020.

OTHER MATTERS

Reminders on IASB® Documents for Comments

In December 2019, the IASB published its Exposure Draft, "General Presentation and Disclosures (Primary Financial Statements)," with comments due June 30, 2020. The IASB has proposed new requirements for presentation and disclosure in financial statements, focusing on the statement of profit or loss. The proposals would result in a new IFRS Standard that sets out general presentation and disclosure requirements relevant to all companies, replacing IAS 1 *Presentation of Financial Statements*.

Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

In September 2019, the IASB finalized its amendments to paragraphs 69-76 of IAS 1 *Presentation of Financial Statements* to clarify the criteria for the classification of a liability as either current or non-current. These final amendments are expected to be issued in January 2020 and would apply for annual reporting periods beginning on or after January 1, 2022.

Goodwill and Impairment

The IASB is investigating possible improvements to accounting for goodwill and impairment to provide users of financial statements with better information about business combinations at a reasonable cost. The IASB's preliminary views will be shared in its upcoming discussion paper, which is expected to be published in February 2020.

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