IFRS Discussion Group

Report on the Public Meeting

December 2, 2013

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

This document has been prepared by the staff of the AcSB and is based on discussions during the Group's meeting.

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

(For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips).

Items Presented and Discussed at the December 2, 2013 Meeting

Update on Previous Items Discussed by the Group

ITEMS PRESENTED AND DISCUSSED AT THE DECEMBER MEETING

Accounting for the Effect of Rising Interest Rates

Interest rates have been at historical lows for some period of time in Canada (and in many other jurisdictions around the world). Recently, there have been indications that interest rates in Canada are expected to rise over the short to medium term.

Under IFRSs, the initial or subsequent measurement of many balances requires interest rates as inputs either for recognition or disclosure purposes. Examples of such items include interest-bearing financial assets, non-financial assets for which an impairment trigger has been identified and an impairment assessment is required, defined benefit employee obligations, asset retirement obligations and long-term debt.

The Group discussed some of the potential accounting implications of an actual or expected increase in interest rates in respect of the following standards:

- IAS 36 *Impairment of Assets*;
- financial instruments standards (i.e., IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 9 *Financial Instruments*, and disclosure requirements under IFRS 7 *Financial Instrument Disclosures*); and
- other standards that require the use of interest-sensitive discount rates, such as IAS 19 *Employee Benefits*; IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IAS 40 *Investment Property* and IAS 41 *Agriculture*.

The Group's Discussion

Group members observed that the effect of a change in interest rates can be quite pervasive. Group members noted that there is a direct effect for some IFRSs with explicit requirements, such as IAS 36 and IAS 39, while the effect is more indirect for other IFRSs, such as IAS 2 *Inventories* and IAS 17 *Leases*.

Group members observed that it is important to take a holistic view because interest rates are integrated with, and affect, many other assumptions. In addition to the risk-free rate, credit spreads and other necessary adjustments must be appropriately considered to achieve an appropriate discount rate.

Group members noted that entities need to consider how changes in interest rates might drive changes in other key variables, such as inflation, commodity prices and foreign exchange rates. This analysis is important not only for measurement but also if presenting any sensitivity analysis or other disclosures. Group members suggested that entities should strive to make sensitivity analyses more than just a mechanical calculation that ignores the interaction of key variables. Group members highlighted the importance of taking a step back to ensure that consistent assumptions about key variables have been used throughout the financial statements. Group members observed that, given there will be a time when interest rates will rise, entities that have not previously done this type of comprehensive analysis should do a holistic calculation, understand where the risks lie and determine if those risks need to be managed.

The Group did not recommend any further action be taken regarding this issue.

Adoption of IFRSs by Investment Funds

The IASB's Investment Entities project was completed in 2012 with the issue of the amendments to IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities* and IAS 27 *Separate Financial Statements*. These amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss, rather than consolidate them, and are effective for annual periods beginning on or after January 1, 2014.

The AcSB had deferred the adoption of IFRSs for investment companies and segregated accounts of life insurance enterprises that are publicly accountable enterprises, pending the completion of the IASB's Investment Entities project. After the IASB issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27) in 2012, the AcSB confirmed that these entities must adopt IFRSs for interim and annual financial statements relating to annual periods beginning on or after January 1, 2014. As the changeover date to IFRSs for these entities approaches, a number of transition issues have arisen. The Group discussed some of these issues:

- accounting for income taxes by investment funds:
  - taxation of mutual fund trusts (Issue 1);
  - withholding taxes (Issue 2);
- calculation of interest income (Issue 3);
- application of IFRS 12 to investment funds:
  - the investment entity exemption (Issue 4); and
  - unconsolidated structured entities and "funds of funds" (Issue 5).

The above list is not exhaustive. Other issues may be encountered by investment funds on transition to IFRSs, including issues that the IFRS Interpretations Committee is currently considering.

Issue 1: Taxation of Mutual Fund Trusts[1]

In Canada, mutual fund trusts are not taxed on income earned in a taxation year, to the extent that such income has been distributed to unitholders prior to the end of the taxation year. Typically, the declaration of trust requires that the mutual fund trust distribute sufficient income to reduce any taxable income to nil and mandates an automatic distribution for any remaining undistributed taxable income at 11:59 pm on the last day of the taxation year. As a result, there is generally little possibility of the trust being taxable on ordinary income under Part 1 of the Income Tax Act.

[1] The meeting report on this issue contains additional details because the Group's discussion was not recorded due to a technician error.

Under pre-changeover Canadian GAAP, investment funds apply the guidance in Section 3465, *Income Taxes,* and EIC 107, Application of CICA 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts, in Part V of the CPA Canada Handbook – Accounting.

Paragraph 3465.83 states: "Taxes related to distributions or future distributions should be given the same accounting treatment as the distributions."

EIC 107 states: "… a tax deduction received by a trust for distributions to unitholders represents, in substance, an exemption from taxation of an equivalent amount of the trust's earnings."

Under pre-changeover Canadian GAAP, the mutual fund was permitted to record no income taxes when the conditions in that EIC are met.

Paragraphs 52A-B of IAS 12 *Income Taxes* states:

> "In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.
>
> In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b)."

The Group considered whether Canadian mutual fund trusts applying IFRSs are within the scope of IAS 12 and are required to record Canadian income taxes. Specifically, whether Canadian income taxes for these trusts can be considered, in substance, tax exempt (*View 1A*), or whether they must record these taxes based on the rate applicable to undistributed profits until the obligation to make such distributions arises (*View 1B*).

View 1A – The mutual fund trust is not required to record income taxes.

Under this view, mutual funds are not required to record Canadian income taxes under IAS 12 because they have an "in-substance" exemption. The declaration of trust legally obligates the entity to distribute income annually to unitholders such that it has no remaining income that could be taxable otherwise. The mutual fund trust has no discretion to avoid these distributions and consequently, there is little possibility of being taxable.

Under this view, similar conditions to those expressed in EIC 107 are applied to IFRSs to assess whether mutual funds have an "in substance" exemption from Canadian taxation and, as a result, paragraphs 52A-B of IAS 12 do not apply. In addition, paragraphs 52A-B of IAS 12 were designed for jurisdictions in which the distributed rate and undistributed rate both differ from zero and an entity may make an economic decision not to make distributions. (For example, when the distributed rate is 35 per cent and the undistributed rate is 40 per cent, an entity may decide to retain cash for expansion rather than distribute cash.)

View 1B – The mutual fund trust is taxable and should record income taxes.

Under this view, there is no basis to exempt mutual funds from IAS 12 because there is no equivalent to EIC 107 under IFRSs. The mutual funds are subject to Canadian taxation, but they reduce their taxation through paying distributions regardless of whether such distributions are contractually required to take place automatically. These trusts must record income taxes based on the rate applicable to undistributed profits until the obligation to make such distributions arises.

The Group's Discussion

Group members supported View 1A that the mutual funds have an "in substance" exemption from Canadian income taxation. Group members noted that this issue was discussed previously during the March 2010 meeting and similar views were expressed.

The Group did not recommend any further action be taken regarding this issue.

Issue 2: Withholding Taxes[2]

Mutual funds that hold foreign securities are often subject to withholding taxes on dividends and other income earned from those investments. Generally, the mutual fund would have no control, joint control or significant influence over the foreign investees. Under pre-changeover Canadian GAAP, the investment income is usually reported net and the amounts withheld are disclosed parenthetically on the statement of income. Paragraph 2 of IAS 12 states, in part: "Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity."

The Group considered whether withholding taxes on income from foreign securities that are not subsidiaries, associates or joint arrangements are income taxes. Specifically, whether the foreign income is required to be presented gross with the amounts withheld shown separately as expense (*View 2A*) or can be presented on a net basis (*View 2B*) under IFRSs.

View 2A – Yes, separate presentation of gross foreign income and withholdings as income tax expense is required.

Although they are arising from financial instruments, rather than subsidiaries, associates or joint arrangements, the withholding taxes on distributions from these investments are income taxes within the scope of IAS 12.

Paragraph 82 of IAS 1 *Presentation of Financial Statements* states: "… the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period … tax expense…"

[2] The meeting report on this issue contains additional details because the introduction to the Group's discussion of this issue was not recorded due to a technician error.

As a result, mutual funds should present foreign income on a gross basis and present withholding taxes as a separate line item.

In some cases, mutual funds may present additional subtotals that are relevant to an understanding of the fund's financial performance in accordance with paragraph 85 of IAS 1. Examples of such subtotals may include the increase (decrease) in net assets attributable to holders of redeemable units before income taxes, income taxes, and net increase (decrease) in net assets attributable to holders of redeemable units.

View 2B – No, income from foreign securities can be presented net of withholdings.

Investments in subsidiaries, associates and joint arrangements are part of the reporting entity. Withholding taxes incurred on distributions from these entities are part of the tax expense on the group's income overall. The investor is able to control, or at a minimum participate in, the decision about the timing and amount of such distributions giving rise to the withholding tax. In substance, the investor is, at least to some extent, operating and earning income that is being taxed in the foreign jurisdiction through withholdings on the distributions. As such, withholding taxes on distributions from these investments are reported as income taxes.

In contrast, the foreign securities are not part of the group. The investor has no input or ability to affect the amount and timing of distributions. The investor is only entitled to the net amount and not the portion of income being withheld. The investor should record income based on the net amount to which it is entitled, without separate recognition of the withholding taxes.

The Group's Discussion

Group members generally supported View 2A that separate presentation of gross foreign income and withholdings as income tax expense is required because the withholding taxes on distributions from these investments are income taxes within the scope of IAS 12.

One Group member questioned whether this view conflicts with View 1A that the mutual funds have an "in substance" exemption from taxation and, therefore, are not in the scope of IAS 12. Group members clarified that in Issue 1, the particular taxes (i.e., Canadian income taxes) are not within the scope of IAS 12 because of the mechanism in place for those taxes. In contrast, in this issue, the particular taxes (i.e., the foreign withholding taxes) are within the scope of IAS 12 because they are not subject to that mechanism.

The Group did not recommend any further action be taken regarding this issue.

Issue 3: Calculation of Interest Income

Investment funds typically account for all investments in financial assets, including debt instruments, at fair value through profit or loss. For debt instruments carried at fair value through profit or loss, IFRSs do not require interest income to be presented separately from other changes in the fair value of the investment. However, in Canada, Part 3.2(2) of National Instrument 81-106 *Investment Fund Continuous Disclosure* requires that interest income be presented as a separate line item on the statement of income.

The Group considered how to present interest income separately from other changes in fair value for financial assets carried at fair value through profit or loss. Specifically, do IFRSs require interest income to be calculated using the effective interest method in such circumstances?

The Group's Discussion

Group members noted that although paragraph 30 of IAS 18 requires interest income to be calculated using the effective interest method, this paragraph applies to the recognition and measurement of interest income. If a bond is being carried at fair value through profit or loss, interest income is recognized as part of the overall change in the fair value of the bond each period and paragraph 30 of IAS 18 does not apply. Further, IFRSs do not require interest income to be presented separately.

Group members observed that a conflict exists between IFRSs and the securities regulations in that the securities regulations require disclosure of interest income for assets that are accounted for at fair value through profit and loss. The majority of Group members supported the view that it is inappropriate to present a separate line item in the statement of profit or loss called "interest income" when the amount is not calculated in accordance with IFRSs (i.e., using the effective interest rate method).

One Group member questioned why interest income using the effective interest rate method specified by IFRSs cannot be calculated and disclosed to meet the securities requirements. Other Group members explained that the IFRS concept of effective interest differs fundamentally from measuring an asset at fair value through profit or loss. The difference between interest income determined on the IFRS effective interest rate method and the overall change in fair value of the interest-bearing assets would be a meaningless amount and possibly confusing to financial statement users if reported in a statement of profit or loss.Some Group members suggested different presentation and disclosure options to achieve both competing objectives (i.e., comply with IFRSs and meet the regulatory disclosure requirements). For example, it may be acceptable to disclose "interest income for distribution purposes" along with a very explicit description of what this amount represents, to avoid confusion that the amount is effective interest. Group members noted that the industry is working towards identifying an appropriate way to meet the regulatory requirements by presentation descriptions and alternatives. Some financial statement preparers face limitations with the systems and data available and may not currently be able to provide both effective interest rate and fair value information, even if one type of information were provided as supplementary disclosure.

The Group did not recommend any further action be taken regarding this issue.

Issue 4: The Investment Entity Exemption

IFRS 12 requires an entity to disclose certain information about investments in subsidiaries, joint ventures, associates and unconsolidated structured entities, including summarized financial information and other information about the nature of, and risks associated with, such investments.

Paragraph 21A of IFRS 12 provides an exemption for investment entities as defined in IFRS 10 from providing summarized financial information about investments in associates and joint ventures that are measured at fair value. Similarly, paragraph 25A of IFRS 12 provides an exemption from some of the disclosures required in paragraph 24 about unconsolidated structured entities that it controls.

The Group considered whether an investment fund without any controlled subsidiaries is required to provide the summarized financial information required by paragraphs 21(b)-(c) of IFRS 12. Specifically, can an investment fund without any subsidiaries qualify as an investment entity for the purpose of applying the disclosure exemption in paragraph 21A of IFRS 12?

View 4A – Yes, the disclosure exemption applies.

An investment fund qualifies for the disclosure exemption in IFRS 12 if it meets the definition of investment entity in IFRS 10, regardless of whether it has any controlled subsidiaries.

View 4B – No, the disclosures are required.

An investment fund without any subsidiaries does not qualify for the disclosure exemption because an entity only applies IFRS 10 to the extent that it has one or more controlled subsidiaries.

The Group's Discussion

Group members supported View 4A that an investment fund that meets the definition of an investment entity qualifies for the disclosure exemption. Group members noted that the definition of an investment entity in IFRS 10 does not require the entity to have controlled investments. The disclosure exemption in paragraph 21A of IFRS 12 applies to any investment entity and not just to a parent that is an investment entity.

The Group did not recommend any further action be taken regarding this issue.

Issue 5: Unconsolidated Structured Entities and Funds of Funds

Some investment funds in Canada have a strategy of investing in other investment funds, referred to as "funds of funds".

A structured entity is defined in paragraph B21 of IFRS 12 as follows:

> "An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements."

Investment funds do not need to provide the disclosures in paragraphs 24-31 of IFRS 12 for investments in unconsolidated structured entities that are controlled if the disclosures in paragraphs 19A-G of IFRS 12 are provided. However, these disclosures are required for any investments that are not controlled and are determined to be structured entities.

The Group considered whether, for practical purposes, investment funds can provide the structured entity disclosures for all underlying funds (*View 5A*), rather than determining which individual underlying funds are structured entities (*View 5B*).

The Group's Discussion

Group members supported View 5A that the investment funds may provide the structured entity disclosures for all underlying funds. Group members noted that View 5B represents the minimum disclosures required and that disclosing this information for all underlying funds (View A) is not precluded. Group members noted that as a practical expedient, funds of funds may provide the structured entity disclosures for all underlying funds, rather than assessing each interest individually to determine whether such disclosures are required. However, Group members observed that an approach falling between providing the disclosures for structured entities only (View B) and all underlying funds (View A) would not be appropriate.

The Group did not recommend any further action be taken regarding this issue.

IFRS 5: Changes to a Plan of Sale

When a non-current asset ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale), paragraph 27 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires a new measurement basis. Paragraph 27 of IFRS 5 states:

> "The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:
>
> (a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and
>
> (b) its recoverable amount at the date of the subsequent decision not to sell."

Paragraph 28 of IFRS 5 provides the following additional guidance that applies when an adjustment is required by paragraph 27 (emphasis added):

> "The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss from continuing operations in the period in which the criteria in paragraphs 7-9 are no longer met. <u>Financial statements for the periods since classification as held for sale shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate.</u> The entity shall present that adjustment in the same caption in the statement of comprehensive income used to present a gain or loss, if any, recognised in accordance with paragraph 37."

The sentence that is underlined above represents a consequential amendment to IFRS 5 as a result of issuing IFRS 11 *Joint Arrangements*.

Prior to this amendment, paragraph 28 of IFRS 5 required all adjustments arising from the application of paragraph 27 to be recognized in profit and loss from continuing operations in the period in which the held-for-sale criteria ceased to be met. However, this guidance conflicted with paragraphs 42-43 of IAS 31 *Interests in Joint Ventures*. During the IFRS 11 project, the IASB staff proposed amending paragraph 28 of IFRS 5 to state that if the disposal group or non-current asset relate to a subsidiary, joint arrangement or associate, any required adjustment to their carrying value shall be carried out retrospectively. The amendment to paragraph 28 of IFRS 5 aimed to introduce consistency with the guidance in paragraph 21 of IAS 28 *Investments in Associates and Joint Ventures* (Amended in 2011):

> "When an investment, or a portion of an investment, in an associate or a joint venture previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method retrospectively as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly."

Other than explaining that the amendment creates consistency between IFRS 5 and IAS 28, the IASB does not articulate the rationale for creating an exception from the general guidance in paragraph 28 of IFRS 5 for any adjustment to be recognized in the period that the held for sale criteria are no longer met. In addition, the IASB does not explain why the exception was extended to subsidiaries and joint operations but not to other non-current assets.

Absent this explanation, it is difficult to determine whether the amendment:

- is limited only to circumstances in which the disposal group that ceases to be classified as held for sale is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate; or
- should be extended to other circumstances, such as a disposal group that contains a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate, as well as other non-current assets.

The Group's Discussion

Group members observed that the current wording could create inconsistent treatment of adjustments to be recognized in the period in which the held-for-sale criteria are no longer met.

Group members noted that the lack of a rationale for the exception in paragraph 28 of IFRS 5 leaves little or no basis for interpreting the requirements. Group members concluded that the application issues noted above cannot be resolved without additional guidance.

The Group recommended that the AcSB refer this issue to the IASB or IFRS Interpretations Committee.

IFRS 6 and IAS 36: Impairment Testing of Exploration and Evaluation Assets

IFRS 6 *Exploration for and Evaluation of Mineral Resources* requires exploration and evaluation assets be assessed for impairment when facts and circumstances suggest that their carrying amount may exceed their recoverable amount. For purposes of assessing exploration and evaluation assets, paragraph 20 of IFRS 6 applies rather than paragraphs 8-17 of IAS 36 *Impairment of Assets*.

Paragraph 20 of IFRS 6 sets out potential indicators of impairment:

> "One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):
>
> a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.
>
> b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.

> c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area.
>
> d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale."

Paragraph 12(d) of IAS 36 requires consideration of an excess of the net assets of an entity over its market capitalization as a potential indicator of impairment. This "market cap" indicator is not included in IFRS 6.

At the Group's October 2012 meeting:

> "Group members expressed fairly consistent views concerning the role of market cap, noting that although it should not be completely ignored in an IFRS 6 context, it alone would not indicate that an impairment exists. Instead, when market cap is less than the carrying amount of an entity's net assets, that fact could be viewed as an indicator that exploration and evaluation assets might be impaired. An entity should then carefully consider the other, more relevant facts and circumstances (i.e., those listed in paragraph 20 of IFRS 6)."

The Group considered how to apply the impairment indicators in paragraph 20 of IFRS 6 when the carrying amount of the net assets of an entity is more than its market capitalization.

Fact Pattern

- A junior exploration entity's market capitalization is significantly below net book value.
- The share price is so low that any share offering or even a convertible debt issuance would significantly dilute current shareholders.
- The entity does not have enough resources to continue with planned exploration and evaluation activities.
- The entity plans to continue to hold the properties but defer any expenditure on them beyond any annual spending commitments, until it can obtain financing that would not significantly dilute current shareholders.

Scenario 1

- There are no or minimal annual spending commitments related to the entity's properties.

Scenario 2

- There are annual spending commitments related to the entity's properties that, if not met, would result in the entity losing its rights to the properties.
- The entity does not have enough resources to meet its annual spending commitments and is attempting to raise funds to meet these commitments.
- The entity has one year to complete its minimum spending commitments.

Under these two scenarios, do any of the four indicators of impairment listed in paragraph 20 of IFRS 6 exist? Do other indicators of impairment exist, given paragraph 20 of IFRS 6 is not an exhaustive list?

The Group's Discussion

Group members noted that their view from the October 2012 meeting has not changed. Paragraph 20 of IFRS 6 is not a checklist and is not an exhaustive list. There could be other indicators that should be considered. Group members observed that paragraph 18 of IFRS 6 provides the guiding principle and requires a holistic approach when assessing whether there are indicators of impairment.

Group members noted that the specific details of the property and what the entity knows about it are quite critical to assessing whether an impairment test is required, particularly when market capitalization remains below net book value for an extended period of time. It is important to consider whether there is bad news, no news or good news about the individual property:

- Bad news is more indicative that an impairment test should be performed.
- No news, over an extended period of time, suggests an entity needs to question why an impairment test should not be performed.
- Good news is property-specific information that supports a view that there is no indication of impairment.

Group members noted that disclosures about significant judgments required by IAS 1 *Presentation of Financial Statements* are important to explain the judgments and risks surrounding the property and fully inform users of the financial statements.

The Group did not recommend any further action be taken regarding this issue.

IFRS 9: Early Adoption of IFRSs with Prospective Application

In June 2013, the Group discussed, on a conceptual basis, the potential implications of a Canadian entity wishing to adopt the hedge accounting provisions of IFRS 9 *Financial Instruments* in a period prior to when the material is included in Part I of the CPA Canada Handbook – Accounting. This issue is being revisited now that the final transition provisions are known following the issuance of the revised version of IFRS 9 in November 2013. Further, the revised version of IFRS 9 will not be included in Part I of the Handbook in 2013 because the AcSB's due process will not be complete.

The transition guidance for the November 2013 version of IFRS 9 requires that the hedge accounting provisions be applied prospectively (subject to two small exceptions outlined in paragraph 7.2.21 of IFRS 9 (2013)). The transition guidance requires an entity to adopt all of the provisions of IFRS 9 when the revised hedge accounting chapter is adopted. Therefore, an entity must also apply the revised classification and measurement criteria for financial assets and financial liabilities in addition to the hedging criteria.

Although the hedge accounting chapter is to be applied prospectively, the classification and measurement requirements must be applied retrospectively subject to certain exceptions outlined in the transition requirements. In many of those exceptions, the requirements of IFRS 9 are applied at the date of initial application, which is the beginning of the first reporting period in which the entity first applies the requirements of the standard.

It is important to note that the mandatory adoption date for IFRS 9 is sometime after 2015 and federally regulated financial institutions are not eligible to adopt IFRS 9 early. Also, Section 3.2(1)(a) of National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards*, requires that financial statements, other than acquisition statements, be prepared in accordance with Canadian GAAP applicable to a publicly accountable enterprise. In other words, reporting issuers need to file financial statements that comply with Part I of the Handbook.

The Group considered the potential implications arising from early adoption of the hedging chapter of IFRS 9. Specifically, what are the potential implications for a reporting issuer that wishes to early adopt IFRS 9 as amended in November 2013 before the standard is included in Part I of the Handbook? What are the potential implications for an entity that is not a reporting issuer?

The Group's Discussion

Group members noted that this issue arises in very limited circumstances and for a limited time.

Group members observed that if a reporting issuer wishes to adopt IFRS 9 before the standard is included in Part I of the Handbook, the issuer would need to apply to the securities regulators for exemptive relief from the requirement in National Instrument 52-107 to file financial statements that comply with Part I of the Handbook. Other entities that are not reporting issuers would need to examine covenants and other arrangements to understand whether it is possible to adopt early (i.e., if only required to comply with IFRSs as issued by the IASB and not Canadian GAAP (Part I of the Handbook)).

The AcSB Chair, Linda Mezon, noted that the process for incorporating IFRS 9 into Part I of the Handbook is underway but based on the time to translate the standard it will not be in Part I of the Handbook prior to December 31, 2013. However, the AcSB is moving as quickly as possible and is aware that some entities wish to adopt the standard in the first quarter of 2014.

Subsequent to the Group's meeting, the AcSB's December 23, 2013 Decision Summary states that: "… the guidance on hedge accounting and other amendments are expected to be issued and become part of Canadian GAAP in the first quarter of 2014."

The Group did not recommend any further action be taken regarding this issue.

IFRIC 21: Levies

IFRIC 21 *Levies* provides guidance on accounting for levies in accordance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This Interpretation is effective for annual periods commencing on or after January 1, 2014 and is applied retrospectively.

IFRIC 21 defines a levy as an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e., laws and/or regulations).

A payment made for the acquisition of an asset, or rendering of services under a contractual agreement with a government, is not a levy. Outflows of resources that are within the scope of other standards (for example, taxes that are within the scope of IAS 12 *Income Taxes*), fines and penalties, and liabilities arising from emission trading schemes are explicitly excluded from the scope of the Interpretation.

IFRIC 21 confirms that an entity recognizes a liability for a levy when, and only when, the triggering event[3] specified in the legislation occurs. An entity does not recognize a liability at an earlier date, even if it has no realistic opportunity to avoid the triggering event.

The Group considered whether certain payments, such as premiums payable under the Workplace Safety and Insurance Board of Ontario (WSIB) plan and property taxes, are within the scope of IFRIC 21.

The Group's Discussion

Group members noted that the scope of IFRIC 21 is potentially quite broad and careful consideration of all types of payments imposed by governments is necessary. One approach is to consider what kind of payments are imposed on an entity by governments and work through a complete list of such payments to identify why each type of payment might not be in the scope of IFRIC 21.

Group members noted that the premiums payable under the WSIB plan may be considered to fall outside the scope of IFRIC 21 because these payments fall within the scope of IAS 19 *Employee Benefits*. However, Group members observed that property taxes appear to fall within the scope of IFRIC 21, in accordance with the criteria in paragraph 4 of the Interpretation, and the application of IFRIC 21 may result in a change in the timing of the liability and expense recognition. Further details about the Group's discussions of these two examples are included in the accompanying Appendix.

Group members observed that many may overlook the potential applicability of IFRIC 21 to these types of payments or prematurely assume that there would be no effect on the accounting treatment. Although property taxes may not be material for some entities, they could be quite significant for certain entities with significant real estate assets.

Group members observed that the discussion has highlighted the potentially broad scope of IFRIC 21. The Group only discussed two of the many possible payments to government that may be within the scope of IFRIC 21. Group members expressed concern that there are many more payments made to governments that need to be assessed under IFRIC 21 and the effective date of January 1, 2014 does not provide much time to do so. Group members encouraged preparers and auditors to focus on IFRIC 21 and spend the necessary time to analyze the various payments made to government under this Interpretation.

Group members considered whether a formal recommendation should be made to the AcSB to refer this issue to the IASB or the IFRS Interpretations Committee. Group members observed that it seems likely there will be significant diversity in practice. Although the Group's discussion has demonstrated the practical difficulties in applying IFRIC 21, it is unclear what part of IFRIC 21 could be clarified.

[3] Triggering event is the obligating event that gives rise to a liability to pay a levy (i.e., the activity that triggers the payment of the levy, as identified by legislation).

Some Group members suggested that, if such a broad scope was intended, perhaps a deferral in the effective date could be pursued.

The Group decided that no formal action should be taken at this time but supported the AcSB Chair's suggestion to discuss the issue with the AcSB as well as the IASB staff in December. Subsequent to the Group's meeting, the AcSB discussed this issue in its December and January meetings and directed staff to take further steps to raise awareness, including another public discussion of this issue by the IFRS Discussion Group in the first quarter of 2014.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IFRS 13: Business Combinations with Consideration Including Shares Subject to Restrictions

At the September 2013 meeting, the Group recommended that the AcSB should bring this issue to the attention of the IASB or IFRS Interpretations Committee.

At the December 2013 meeting, the AcSB staff reported that the AcSB agreed with the Group's recommendation and directed staff to communicate with the staff of the IASB to determine the best way to move this issue forward.

IFRS 11: Application Issues

At the September 2013 meeting, the Group considered six issues regarding the classification of a joint arrangement as a joint venture or a joint operation and the accounting for joint operations under IFRS 11 *Joint Arrangements*. The Group noted that these six issues are currently being considered by the IFRS Interpretations Committee.

At the December 2013 meeting, the AcSB staff reported that in November the IFRS Interpretations Committee considered a summary of the results of the outreach that was conducted on implementation issues arising from IFRS 11. For further details refer to the Interpretations Committee's work in progress section in the November 2013 IFRIC Update.

Appendix to the discussion of IFRIC 21: Levies

Example 1: Premiums payable under the WSIB plan

In Ontario, most employers are required to register with the WSIB. The WSIB is legislated by the Ontario government and is responsible for administration of the Workplace Safety and Insurance Act. The payment of premiums to the WSIB will result in an outflow of resources embodying economic benefits (for example, payment of cash) to the WSIB, which is legislated by the Ontario government.

The Ontario WSIB plan is understood to be relatively consistent with similar plans across the other provinces.

The premiums are based on payroll costs and injury experience and not taxable profit. The WSIB premiums are based on the premium rates set by the WSIB and employers are required to pay premiums up to a maximum amount of insurable earnings per employee. Payments are due as long as the eligible employee is employed and is on the payroll. Currently, employers pay the WSIB premiums on a monthly basis and recognize the related cost as salaries and wages are earned.

Do the premiums payable under the WSIB plan fall within the scope of IFRIC 21?

The Group's Discussion

Payments within the scope of any IFRS other than IAS 37 are not within the scope of IFRIC 21. Group members observed that the premiums paid to the WSIB do not fall within the scope of IAS 12 as specified in paragraph 2 because they are based on payroll costs and injury experience rather than taxable profit. However, the premiums may be considered to fall within the scope of IAS 19 *Employee Benefits* (Amended 2011). Group members noted that, under paragraphs 4 and 44-45 of IAS 19, the WSIB plan could be considered to be a "state plan" in the scope of IAS 19 because:

- it is established by legislation to cover all entities or all entities in a particular category given the WSIB plan is established by the Workplace Safety and Insurance Act legislation;
- it is operated by local government given the WSIB is legislated by the Ontario government; and
- it is not subject to the control or influence by a reporting entity.

As a result, the premiums payable under the WSIB plan appear to be outside the scope of IFRIC 21 because these payments fall within the scope of IAS 19. Additionally, Group members noted that even if the WSIB were not considered to be a state plan under IAS 19 and is in the scope of IFRIC 21, there would be no change to the current practice of recognizing the liability because the payments are due over time as long as an employee is on the payroll. As a result, the triggering event occurs progressively over time.

The Group did not recommend any further action be taken regarding this example.

Example 2: Property taxes

In Canada, municipalities have the power to levy property taxes. Property taxes are levied on a property situated within the boundaries of a municipality. Taxes are generally calculated based on an annual period and are billed at varying times throughout the year. The amount of tax paid depends on the value of the property on the assessment date and the rate applicable to the nature of the property, such as residential or commercial. Municipalities charge property taxes for an annual period and stipulate the timing for payment of taxes.

The Group considered whether property taxes fall within the scope of IFRIC 21 and, if so, whether the triggering event is ownership of the property at the specific date (*View A*) or ownership of the property over the period to which the tax relates (*View B*).

Is there an outflow of resources embodying economic benefits to the government(s)?

The payment of property taxes will result in an outflow of resources embodying benefits (for example, a payment of cash) to the municipal governments and could potentially be within the scope of IFRIC 21.

Is the payment within the scope of other standards or a fine/penalty imposed for breach of legislation?

Payments made for property taxes are within the scope of IAS 37 and do not fall within the scope of any other standard. Property tax is not a fine or penalty imposed for breaches of legislation.

Is payment imposed in accordance with legislation?

The payment of property taxes is imposed in accordance with legislation by each municipality (for example, in the City of Toronto Act (2006)).

Is payment for acquisition of an asset, or for the rendering of services under a contractual agreement with a government?

The question arises whether the property taxes are effectively paid to the government for the rendering of services. The payment is made so that the levying municipality has funds to be able to render basic city services (for example, local road maintenance, signage, lighting, local first-responder services). However, property taxes are not paid "under a contractual agreement" between the specific property owner and the municipal government as required by paragraph 5 of IFRIC 21.

While additional factors should be considered prior to concluding that property taxes are within the scope of IFRIC 21, any conclusion may be irrelevant if the timing of the recognition of the liability to pay the property taxes does not change. Therefore, one approach is to consider whether IFRIC 21, if applicable, would affect current accounting practice and only if current practice would change once IFRIC 21 becomes effective, consider further whether the liability is in the scope of IFRIC 21.

Is the current practice of recognizing the liability consistent with the triggering event?

What is the triggering event under IFRIC 21?

View A: The triggering event is ownership of the property at a specific date.

Under this view, the obligation for payment of the property taxes to the municipal government is not triggered until a specified date. Paragraph 8 of IFRIC 21 states that:

> "The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation."

Accordingly, an obligation for property tax would only be recognized upon ownership of the property on a specified date. That specific date may vary by municipality in accordance with the legislation. Possible dates might be the assessment date, the beginning of the property tax year, the billing date (interim or final) or the due date (as each instalment, interim or final, is due). The determination of the appropriate date would require careful review of the applicable legislation.

Pre-payment or a pro-rata amount is not required to be submitted to the government if the property owner sells or transfers ownership of the property to another party prior to the due date. If a property is sold and property taxes remain unpaid, the municipality may be entitled to continue to seek payment from the previous owner but generally the municipality's more practical recourse is to put a lien on the property. Similarly, if a property is sold and the previous owner (i.e., the seller) has already paid the property taxes for the year, that previous owner is not entitled to a refund of taxes paid from the municipality.

In practice, an adjustment may be made to the consideration to be exchanged between the buyer and the seller for any property taxes paid in advance or due in arrears. However, such a payment or adjustment is not required by the legislation and, therefore, should not be considered under IFRIC 21.

View B: The triggering event is ownership of the property over the period to which the tax relates.

Under this view, the activity that gives rise to the payment of the levy is ownership of the property, which occurs over the period in which the property is held, rather than at a specific date. While payment may be deferred until a future date, under the legislation, property taxes are determined and payable based on the assessed value of the property during the tax period. The fact that upon the sale of a property an adjustment in the consideration to be exchanged is made between the buyer and the seller for any property taxes due in arrears or paid in advance indicates that the obligation for payment of the taxes occurs over time. Under this view, the property taxes should be recognized progressively in accordance with paragraph 11 of IFRIC 21 because municipalities charge property taxes for an annual period and stipulate the timing for payment of taxes.

What is the current accounting practice under IAS 37?

In practice, entities generally recognize property taxes on a monthly basis. The amount is estimated based on the instalments due (for example, an interim bill), if the final bill is not yet available.

Is the current practice of recognizing the liability consistent with the triggering event?

If the triggering event is ownership of the property at a specific date (*View A*) rather than over time (*View B*), the application of IFRIC 21 will result in a change in the accounting.

If View A is the appropriate application of IFRIC 21 and it is determined that recognition of the liability for the levy gives rise to an expense rather than an asset, the effect on the statement of comprehensive income for a quarterly interim period reporting entity will create significant differences in the timing of recognition of the expense. Comparisons of different interim periods of a single entity and comparisons between entities will be affected. The differences in timing of recognition will be pervasive because property taxes are levied universally across all municipalities and across all industries as a significant routine form of revenue generation for local governments in order to provide basic services to local residents.

The Group's Discussion

The Group's Chair asked whether any Group members thought there was a basis to argue that property taxes are outside the scope of IFRIC 21 based on paragraph 5. Many Group members indicated that to argue that a contractual arrangement exists is difficult to support because the tax payer has no ability to negotiate a contract and the payment is a non-reciprocal and non-exchange transaction. Further, the perceived link between services received in exchange for the levy appears to be indirect at best.

Group members noted that it is not clear under View A whether the triggering event is the assessment date, beginning of the property tax year, billing date or the due date. Group members observed that the details might vary by municipality because the legislation is specific to each municipality. Also, the legislation may not be clear because it is not written with the objective of clearly identifying the activity that triggers the obligating event. Group members also noted that it may be difficult to justify the current accounting practice of accruing the liability evenly over the year under IFRIC 21 because upon sale, any property taxes paid or owed follow the property rather than the owner.

One Group member suggested looking at whether a change in the use of the property, such as demolishing the building, would cause the municipality to reassess the property value for the period. However, other Group members noted that this argument may not support View B because the reassessment following a change in use will benefit the current property owner rather than the property owner when the use of the property changed.

Some Group members observed that any instalment payment options available to the property owner may be viewed as a financing arrangement or a convenience to the municipality and should not affect the timing of the recognition of the liability for property taxes. Further, it does not make sense to arrive at different accounting results depending on the instalment plan elected by the tax payer.

Group members observed that IFRIC 21 solely focuses on the recognition of the liability and does not deal with the asset or expense recognition. Group members noted that the discomfort with View A is primarily due to the "lumpiness" of expense recognition that may result. Although paragraph 14 of IFRIC 21 notes that an asset should be recognized for any payments made before the obligating event, Group members were not clear on whether an asset could be recognized after the obligating event has occurred.

As noted above, Group members had not yet fully formulated their views on many of the issues discussed with respect to property taxes. Accordingly, the Group will discuss this example further in an additional public meeting expected to be held in the first quarter of 2014.