IFRS Discussion Group

Report on the Public Meeting

January 12, 2012

(*For a full understanding of the discussions and views expressed at the public meeting, interested parties should listen to the recording of the full discussion here*).

Items Presented and Discussed at the January Meeting

ITEMS PRESENTED AND DISCUSSED AT THE JANUARY MEETING

Preparing Annual IFRS Financial Statements

Group members from two of the provincial securities regulators provided an update for entities on matters to consider when preparing their first annual financial statements under IFRSs.

Cameron McInnis, Chief Accountant of the Ontario Securities Commission, noted that entities should spend more time on areas with measurement and disclosure requirements that are new to Canadians or new to the annual IFRS financial statements compared to the interim financial statements. Mr. McInnis highlighted business combinations, impairments, and disclosures about significant judgments, estimation uncertainty and going concern as areas that entities should consider carefully. Mr. McInnis observed that going concern disclosures continue to be an area of focus and reminded the Group of the IFRS Interpretations Committee's agenda decision "IAS 1 Financial Statement Presentation – Going concern disclosure" published in the July 2010 IFRIC Update. Mr. McInnis noted other areas that are new or different under IFRSs include provisions, fair value measurements, and debt classification.

Lara Gaede, Chief Accountant of the Alberta Securities Commission, noted that issuers should consider the Commission's 2011 Corporate Finance Disclosure Report, published in December 2011, when preparing annual IFRS financial statements. Ms. Gaede highlighted that issuers need to provide relevant and useful disclosures and avoid using boilerplate disclosures. Ms. Gaede provided some examples of additional income measures not prescribed in IAS 1 *Presentation of Financial Statements* that cause concern and summarized staff expectations about the use of these measures.[1]

Group members noted some additional areas that Canadians should focus on when preparing their first annual IFRS financial statements including key management personnel disclosures, related party transactions, IFRS 1 *First-time Adoption of International Financial Reporting Standards* disclosures, and the requirement to include an explicit and unreserved statement of compliance with IFRSs in accordance with IAS 1.

IFRS 1: Change in Date of Transition to IFRSs

In some cases, subsequent to the distribution of its first IFRS interim or annual financial statements, an entity may determine that for securities regulatory or other reasons there is a requirement for IFRS financial statements to be provided for periods prior to its date of transition to IFRSs. The issue considered by the Group was whether an entity can change its date of

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[1] The "Canadian Securities Administrators' Staff Notice 52-306 (Revised) Non-GAAP Financial Measures and Additional GAAP Measures" was updated on February 17, 2012 to provide further guidance on disclosure of additional GAAP measures presented under IFRSs.

transition to IFRSs after filing its first interim IFRS financial statements or after filing its first annual IFRS financial statements.

Fact Pattern:

- In May 2011, a Canadian public company files its first interim financial statements reflecting the date of transition to IFRSs of January 1, 2010.
- The company is considering filing a prospectus in a foreign jurisdiction either in June 2011 or April 2012.
- The foreign regulator requires the company to provide two years of comparative figures under IFRSs (i.e., for the periods ending December 31, 2010 and 2009).
- If the Company decides to wait until April 2012 to file the foreign prospectus, the company expects to file its first annual IFRS financial statements reflecting the date of transition to IFRSs of January 1, 2010 in March 2012.

In this fact pattern, can the company change its date of transition to IFRSs from January 1, 2010 to January 1, 2009 to provide an additional year of comparative figures under IFRSs if it decides to pursue the foreign filing in:

- June 2011, prior to publishing its first annual IFRS financial statements; or
- April 2012, after publishing its first annual IFRS financial statements?

The Group's Discussion

If the company pursues the foreign filing prior to publishing its first annual IFRS financial statements, Group members observed that IFRS 1 *First-time Adoption of International Financial Reporting Standards* would allow the company to change its date of transition to IFRSs but noted complications may arise (for example, needing to refile interim financial statements). However, if the company in the above fact pattern pursues the foreign filing in April 2012, Group members noted that IFRS 1 does not allow the company to change its date of transition after publishing its first annual IFRS financial statements.

Some Group members observed that entities who have experienced this issue had sought to identify alternative solutions through communications with the applicable foreign regulator. In those instances, early discussions with the foreign regulator were key to achieving some form of resolution. Group members also noted that private enterprises considering an initial public offering in Canada should plan their transition to IFRSs to meet regulatory requirements and would need to seek exemptive relief if unable to do so.

The Group concluded that this issue should not be brought to the attention of the IFRS Interpretations Committee because significantly divergent interpretations are not expected to emerge in practice.

IFRS 2 & IAS 32/39: Recognition of Share Purchase Warrants

When an entity issues share purchase warrants or other forms of debt or equity securities in a public or private placement, it is common that the entity concurrently issues warrants to the party brokering or underwriting the offering. The terms of the share purchase warrants issued to the brokers or underwriters as consideration for the services provided (broker warrants) may be identical to the terms of the warrants issued to investors.

The issue considered by the Group was whether the broker warrants should be accounted for in accordance with IFRS 2 *Share-based Payment* or in accordance with IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement.*

Fact Pattern:

- An issuer engages a broker to provide services relating to a public offering of share purchase warrants on the issuer's common shares.
    - The shares are priced and sold in Canadian dollars. The issuer's functional currency is US dollars.
    - The warrants are required to be settled by the delivery of equity shares.
    - The warrants do not have any cash settlement option or any net share settlement option.
    - As a form of compensation for services, the broker receives a number of share purchase warrants with terms that are identical to the terms of the warrants that were issued in the offering.

In this fact pattern, are the warrants issued to the broker in the scope of IFRS 2 (*View A*) or IAS 32 and IAS 39 (*View B*)? If the warrants issued to the broker are within the scope of IFRS 2 (*View A*), should measurement subsequent to issuance be within the scope of IFRS 2 (*View A1*) or IAS 32/39 (*View A2*)?

The Group's Discussion

Group members noted that the broker warrants were issued to the broker for services pertaining to the public offering. Paragraph 2 of IFRS 2 requires an entity to apply IFRS 2 in accounting for all share-based payment transactions, including transactions in which the entity receives services, with only a few exceptions. Group members noted that the broker warrants in the above fact pattern do not meet the requirements for those exceptions.

Similarly, Group members noted that the scope requirements in paragraph 4(f) of IAS 32 exclude share-based payment transactions to which IFRS 2 applies, with the same few exceptions that the broker warrants do not meet.

Several Group members noted that, based on a close reading of those scope provisions in IFRS 2 and IAS 32, the broker warrants in the above fact pattern are clearly in the scope of IFRS 2 and some questioned why an issue arises. Some Group members explained that, despite the clarity of the IFRSs, this issue arises in practice because some may inadvertently account for the broker warrants in the same manner as the warrants issued in the public offering. Those warrants have the same terms as the warrants issued in the public offering and represent only a small subset of the larger issuance of warrants. However, such a conclusion would not take into account that IFRS 2 applies to the broker warrants.

Also, Group members observed that this issue arises in practice, in part, because the consequences relating to the "fixed for fixed" requirements in IAS 32 may drive a substantively different accounting result for the warrants issued in the offering and the warrants issued for services to the broker. Although Group members acknowledged this difference may be surprising, there was no support for the argument that the broker warrants should be classified as a financial instrument (i.e., *View B*) to eliminate the potential difference in measurement bases that would arise if the broker warrants were determined to be within the scope of IFRS 2.

Group members noted that subsequent measurement of the broker warrants is within the scope of IFRS 2 (i.e., View A1), at least until the warrants vest. Some diversity in views was expressed on whether the accounting treatment for the vested warrants is within IFRS 2 or IAS 39. This difference in views was not explored further.

The Group concluded that this issue should not be brought to the attention of the IFRS Interpretations Committee because significantly divergent interpretations are not expected to emerge in practice.

IFRS 11: Classification of Limited Partnerships Subject to Joint Control

IFRS 11 *Joint Arrangements* requires an entity to classify a joint arrangement as a "joint operation" or a "joint venture". This classification is important because the accounting treatment depends on the type of joint arrangement. Paragraphs B14-B33 of IFRS 11 provide application guidance on classifying a joint arrangement.

Limited partnerships are widely used as an ownership structure for joint arrangements in Canada and other parts of the world because of certain tax advantages. Under some legal frameworks, a partnership is not a separate entity at law and, accordingly, partners generally would have direct pro rata interests in partnership assets and liabilities. Limited partnership provisions modify this basic legal framework to create a separation for limited partners.

Some partnership acts in Canada have terms such as:

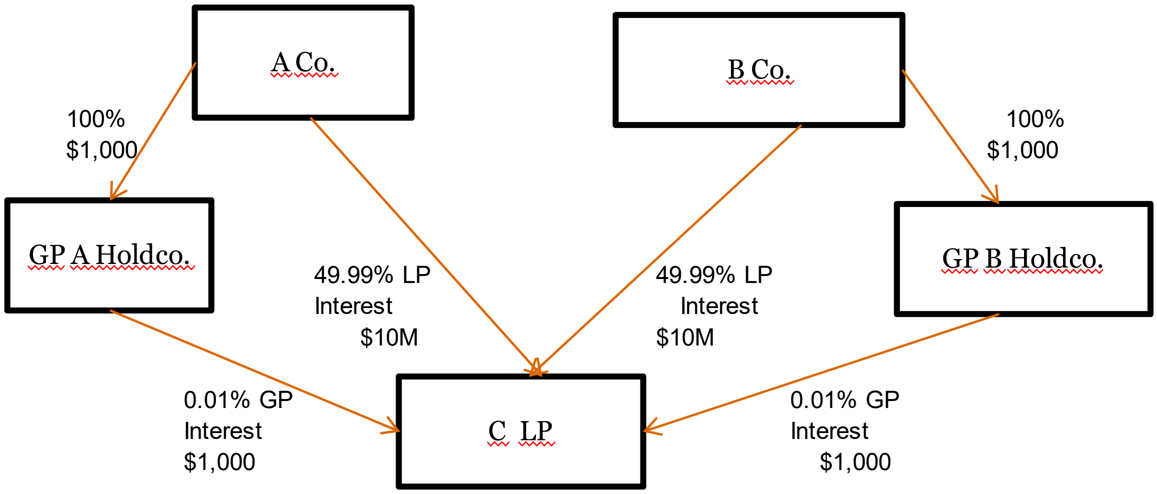
> **Partners bound by acts on behalf of firm**
>
> **8(1)** An act or instrument relating to the business of the firm and done or executed in the firm name, or in another manner showing an intention to bind the firm, by a person authorized in that behalf, whether a partner or not, **binds the firm and the partners.**
>
> **(2)** Subsection (1) does not affect any general rule of law relating to the execution of deeds, instruments or documents affecting land.
>
> **Liability of limited partner**
>
> **57** Subject to this Part, **a limited partner is not liable for the obligations of the limited partnership** except in respect of the amount of property the limited partner contributes or agrees to contribute to the capital of the limited partnership.
>
> (The Partnership Act of Alberta, emphasis added)

Often the parties having joint control over a limited partnership own a pro rata portion of limited partnership and general partnership interests. Exposure to loss on limited partnership investments is limited to the capital invested. However, legally, exposure to loss in excess of invested capital for the general partnership interest is unlimited.

The issue considered by the Group was whether a joint arrangement that is structured as a limited partnership should be classified as a joint operation under IFRS 11 by virtue of its legal form.

Fact Pattern:

- A Co. and B Co.:
  - form a limited partnership, C LP;
  - invest $10 million each in 49.99% in a limited partnership interest in C LP, which are entitled to 99.98% of distributions and 99.98% of net assets on liquidation; and
  - invest a nominal amount (say $1,000) each to establish holding corporations GP A Holdco and GP B Holdco, in which each owns 100% of the shares and has control.
- Each of the GP Holdcos invests the $1,000 in a general partnership interest in C LP for an interest of 0.01%.



Should a limited partnership structure, such as the one described above, always be classified as a joint operation under IFRS 11 by virtue of its legal form (*View A*) or does the arrangement confer separation and qualify as a joint venture under IFRS 11 unless other fact and circumstances indicate otherwise (*View B*)?

The Group's Discussion

Group members expressed support for View B because, in this fact pattern, A Co. and B Co. do not have direct rights to the assets of C LP. As a result, Group members noted that the arrangement does confer separation between the assets of the joint arrangement and A Co. and B Co.. Paragraph B24 of IFRS 11 states:

> "The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (ie the assets and liabilities held in the separate vehicle are the parties' assets and liabilities)."

Also, Group members observed that the arrangement should be considered in the context of paragraph B14 of IFRS 11, which states, in part, that the classification "depends upon the parties' rights and obligations arising from the arrangement in the normal course of business." The general or limited partner would not have access to the assets of the limited partnership or the obligation for the liabilities of the limited partnership in the normal course of business.

As a result, Group members noted that the legal form in this fact pattern is not sufficient to conclude that the joint arrangement is a joint operation and A Co. and B Co. need to consider all factors in determining the classification of the joint arrangement. Group members concluded that this issue should not be brought to the attention of the IFRS Interpretations Committee because diversity should not emerge in practice given the application guidance in IFRS 11.

IFRS 11: Guarantees of Debt of a Joint Arrangement

As noted above, IFRS 11 *Joint Arrangements* requires an entity to classify a joint arrangement as a "joint operation" or a "joint venture". This classification is important because the accounting treatment depends on the type of joint arrangement. Paragraphs B14-B33 of IFRS 11 provide application guidance on classifying a joint arrangement.

At inception, a joint arrangement will generally have little credit and few assets to support purchases. In order to commence operations, parties in a joint arrangement commonly provide guarantees to third parties for the obligations of the joint arrangement. The issue considered by the Group was whether an arrangement should always be classified as a joint operation under IFRS 11 when the liabilities of the joint arrangement are guaranteed by the parties to the arrangement (*View A*) or whether the guarantee is only one factor to consider in assessing the classification of the arrangement (*View B*).

The Group's Discussion

Group members observed that IFRS 11 is clear that a guarantee is only one factor to consider in assessing the classification of the arrangement. Group members noted that paragraph B27 of IFRS 11 explicitly states that the provision of guarantees is not sufficient to conclude that the joint arrangement is a joint operation:

> "The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee)."

Group members concluded that this issue should not be brought to the attention of the IFRS Interpretations Committee because diversity should not emerge in practice given that the issue is specifically addressed in the application guidance in paragraph B27 of IFRS 11.

IAS 8: Disclosure Requirements for Retrospective Application of New Standards

The IASB has issued a number of new and revised IFRSs that require retrospective adoption in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Paragraph 28(f) of IAS 8 states:

> "When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
>
> …
>
> (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
>
> (i) for each financial statement line item affected; and
>
> (ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share."

The issue considered by the Group was what information should be disclosed to meet the requirements in paragraph 28(f) of IAS 8, specifically in the context of the new standards that have an effective date of January 1, 2013.

Fact Pattern:

- A parent company with a December 31 year end is required to adopt IFRS 10 *Consolidated Financial Statements* on January 1, 2013.
- The parent company determines that an entity that it consolidated for the years ending December 31, 2012 and 2011 under IAS 27 *Consolidated and Separate Financial Statements* should not be consolidated under IFRS 10.

In this fact pattern, questions arise about what information the entity needs to collect in 2013 to meet the disclosure requirement in paragraph 28(f) of IAS 8 for the "current period".

The Group's Discussion

Several Group members noted that paragraph 28(f) of IAS 8 requires the parent company to provide information about the entity that is no longer being consolidated in 2013. However, to do so, the parent company would need to continue to run dual reporting systems in 2013 (in addition to running dual reporting systems in 2012 to provide comparative figures under IFRS 10).

Some Group members expressed concern that the cost of requiring the parent company to maintain two reporting systems for 2013 exceeds the benefit of providing this information to the users. These group members noted that this information may not be useful to the financial statement users, in part, because the 2013 financial statements are required to apply IFRS 10 consistently for the current and comparative year. Some Group members also expressed concern that the cost to meet this disclosure requirement upon adopting other new standards, such as IFRS 9 *Financial Instruments*, could be prohibitive.

Other Group members noted that the information about what the financial statements would report if the entity was consolidated in 2013 is useful information for users that do not necessarily have the ability to understand the effect of significant changes to accounting policies. Some noted that the disclosures required by paragraph 28(f) of IAS 8 are relevant to users and the information should not be omitted without careful consideration.

Group members discussed whether an argument that those disclosures are not required can be based on impracticability or materiality. Although Group members noted that those arguments may be appropriate in some circumstances, the purpose of the Group's discussion was to focus on what entities are required to provide to meet the disclosures required in paragraph 28(f) of IAS 8.

Group members questioned whether transitional relief from those disclosure requirements was considered by the IASB in developing IFRS 10 or the IASB's recently issued Exposure Draft, "Transition Guidance (Proposed Amendments to IFRS 10)." The Group directed the AcSB staff to obtain additional information from the IASB. The Group expects to consider this additional information and decide whether the AcSB should bring this issue to the attention of the IFRS Interpretations Committee or the IASB at a future meeting.

IAS 10: Reissuing Financial Statements in Connection with an Offering Document

An entity involved in the issuance of its securities is required by securities legislation to provide financial and non-financial information to investors through various types of securities offering documents, including prospectuses, private placement offering memoranda, issuer bid circulars and information circulars. In practice in Canada and the United States, an entity may need to revise its previously issued annual financial statements in connection with an offering document. Also, the entity's auditor needs to provide consent to the inclusion or incorporation by reference of its audit report on the annual audited financial statements in that offering document.

Current practice in Canada and the United States typically results in the Company revising its previously issued annual financial statements to reflect a change in reportable segments, a discontinued operation, or a retroactive change in accounting policy on a basis that is comparable to its most recently filed interim financial statements. Generally, no other type of subsequent event triggers the reissuance of the previously issued annual financial statements. In the past, an auditor would "double date" the audit report to communicate that the audit work was extended only to audit the effects of the subsequent event that triggered the reissuance. This approach is based on the guidance in Section 7110 of the CICA Handbook – Assurance, *Auditor Involvement with Offering Documents of Public and Private Entities.*

The issue considered by the Group was how subsequent events should be reflected in financial statements prepared in accordance with IFRSs that are reissued in connection with securities offering documents filed in Canada or the United States.

Fact Pattern:

Company A's facts are as follows:

December 31, 2011	Year end
February 15, 2012	2011 audited financial statements under IFRSs filed with regulator
March 15, 2012	Operation discontinued (qualifies as discontinued operation)
March 16, 2012	Company receives final tax assessment for prior years from the Canada Revenue Agency that results in a material charge in first quarter profit or loss
March 31, 2012	First quarter end
April 15, 2012	Files first quarter interim financial statements (reflects the discontinued operation and the tax charge)
May 30, 2012	Files prospectus in Canada and the United States and reissues annual financial statements for the 2011 year end to reflect the discontinued operation

Upon reissuance of the annual audited financial statements for inclusion in a prospectus offering, does Company A need to restate its 2011 annual financial statements for subsequent events other than the discontinued operation (namely, the settlement of the final tax assessment related to prior years), which occurred subsequent to the original date the financial statements were authorized for issue (date of authorization)?

View A – Refiled financial statements are not reopened for subsequent events other than a change in reportable segments, a discontinued operation, or a retroactive change in accounting policy

IAS 10 *Events after the Reporting Period* does not explicitly provide guidance on reissuance of financial statements (and specifically in the context of preparing financial statements for inclusion or incorporation by reference in offering documents). Therefore, other applicable frameworks and guidance should be considered, including the specific guidance contained in US literature on reissuance, which is very similar to current Canadian auditing literature and regulatory practice.

View B – Refiled financial statements are reopened for all subsequent events

Since IAS 10 requires a single date of authorization, all adjusting subsequent events through to that date of authorization are required to be adjusted regardless of whether any interim financial statements reflecting such subsequent events have been published. The reissuance prompts the company to update the original date of authorization, which requires that management consider all events occurring up to the revised date of authorization in the preparation of the financial statements.

The Group's Discussion

Group members noted that the issue arises, in part, because of the interaction between the requirements in IAS 10 and Canadian securities law. However, Group members observed that IAS 10 is silent on reissuances. Group members observed that in many jurisdictions an entity is not permitted by law to reissue financial statements and, as a result, IAS 10 was likely not written in the context of reissuing financial statements in connection with an offering document in a North American environment.

Although several Group members noted that it is difficult to support View A based on IAS 10, they expressed concern over the implications of adopting View B in practice in Canada. Some Group members noted that View B could have a significant negative effect in Canada, including delays in the ability to access capital markets and investor confusion due to increases in the number of financial statements that need to reissued.

Group members questioned whether other actions can be taken in Canada to mitigate this issue and provide an interim solution for Canadian entities. The Auditing and Assurance Standards Board staff indicated consideration could be given to several suggestions.

Some Group members expressed concern that these suggestions would not resolve this issue for entities in Canada and other jurisdictions that are registered with the US Securities and Exchange Commission. Some Group members observed that there is well-established practice in North American capital markets for treating subsequent events in accordance with View A. As a result, some Group members were concerned that without an accounting solution to this issue, significant diversity in practice in Canada and other jurisdictions will emerge. Group members noted that this issue is widespread when considering that the issue has implications for entities filing offering documents in Canada or the United States.

As a result, the Group recommended that the AcSB refer this issue to the IFRS Interpretations Committee. Also, Group members observed that the IASB staff has started work on reissuance in the past and directed the AcSB staff to determine the status of this work.

IAS 23: Capitalization of Borrowing Costs on Major Renovations

Borrowing costs that are within the scope of IAS 23 *Borrowing Costs* and are directly attributable to the construction of a qualifying asset must be capitalized. Paragraph 5 of IAS 23 defines a qualifying asset as "an asset that necessarily takes a substantial period of time to get ready for its intended use or sale." The issue considered by the Group was whether a major renovation to an investment property that does not result in any reduction in revenue is a qualifying asset under IAS 23. For example, a significant upgrade to the lobby or the exterior facade of the building that will take longer than a year to complete and allow the investment property to remain fully leased during the renovation (i.e., there will be no decrease in revenue).

View A – Upgrade is not a qualifying asset

The investment property is being used as "intended" because the investment property remains fully leased during the period of the upgrade with no reduction in revenue.

View B – Upgrade is a qualifying asset

The investment property is not operating as "intended" during the upgrade because the area being upgraded is not accessible to the tenants. Also, the area being upgraded is considered to be a separate part of the property, as explained in paragraph 24 of IAS 23:

> "When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale."

The Group's Discussion

Some Group members expressed concern that the upgrade program would not result in an increase in revenue, noting that "intended use or sale" may imply that there may be additional capacity or ability to generate revenue. Other Group members noted that the upgrade may be necessary to maintain existing revenue because buildings are rated into various classes that determine how much rent can be earned.

Group members observed that applying IAS 23 is optional for qualifying assets that are measured at fair value in accordance with paragraph 4(a) of IAS 23. Given that many entities in the real estate industry apply the fair value model under IAS 40 *Investment Property*, Group members noted that the issue arises for some because the decision to capitalize or expense borrowing costs could have a significant effect on key non-GAAP performance indicators. For example, the decision to capitalize or expense borrowing costs may affect measures of reported funds from operations because, in practice, entities in the real estate industry generally exclude fair value changes from funds from operations.

Group members observed that the issue also arises for renovations to assets included in the scope of IAS 16 *Property, Plant and Equipment* and investment properties that are measured using the cost model under IAS 40. For renovations under these scenarios, the issue is broader because the decision to capitalize or expense borrowing costs would have an effect on net income. Group members discussed these broader scenarios including the interaction between the requirements in IAS 23 to capitalize interest and IAS 16 to commence depreciation and the different terminology used in these IFRSs (for example, "components" in IAS 16 and "parts" in IAS 23).

Group members noted that judgment needs to be applied when determining whether a renovation meets the definition of a qualifying asset under IAS 23. Group members observed that the appropriate accounting treatment appears to depend heavily on the facts and circumstances of the renovation. As a result, Group members concluded that this issue should not be referred to the IFRS Interpretations Committee. Also, Group members agreed the issue could be revisited should significant diversity emerge in practice in Canada.

IAS 28: Dilution in Ownership Interests

An interest in an associate may be diluted in a way that decreases the percentage ownership interest held but does not change the nature of the relationship between the investor and the investee.

Paragraphs 18-19 of IAS 28 *Investments in Associates* provide specific guidance on the accounting requirements when an investor loses significant influence over an associate. Paragraph 19A of IAS 28 also addresses the reclassification to profit or loss of amounts previously recognized in other comprehensive income in relation to that associate. The guidance states, in part, "if an investor's ownership interest in an associate is reduced, but the investment continues to be an associate, the investor shall reclassify to profit or loss only a proportionate amount of the gain or loss previously recognised in other comprehensive income."

The IFRS Interpretations Committee discussed the issuance of shares by an equity method investee in 2009 and published an agenda decision on page 3 of the July 2009 IFRIC Update. This notice referred to paragraph 19A of IAS 28 indicating that any reclassification of amounts previously reported in other comprehensive income upon a dilution of ownership interest is generally required as part of determining the (overall) gain or loss on disposal.

Notwithstanding the guidance cited above, questions have arisen in practice about the recognition of dilution gains and losses upon the reduction of an ownership interest in an associate. The issue considered by the Group was how dilutions in an ownership interest should be accounted for under IAS 28 in two different scenarios that cause the dilution in the ownership interest.

Scenario 1 – An Associate Issues Shares

The issue considered by the Group was whether paragraph 19A of IAS 28 is directly applicable when dilution occurs because the associate issues shares to another party.

The Group's Discussion – Scenario 1

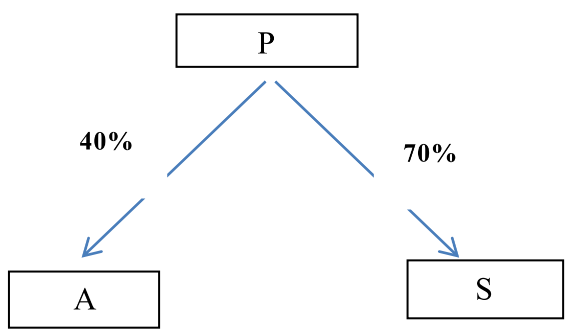
Group members observed that the requirements of paragraph 19A of IAS 28 apply in this fact pattern and concluded that the issue should not be referred to the IFRS Interpretations Committee because there was no diversity of views.

Scenario 2 – An Associate Is Sold to a Subsidiary that Is Less than Wholly owned

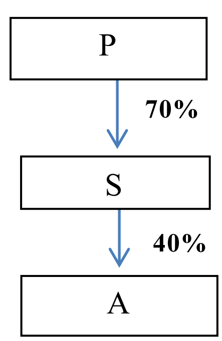
When an entity sells an interest in an associate to a subsidiary that is not wholly owned the accounting treatment for the transaction is more complex.

Fact Pattern:

- Entity P (P) has a 40% interest in Entity A (A) and a 70% interest in Entity S (S).
- P has significant influence over A and, therefore, A is considered an associate under IAS 28.
- P has control over S and, accordingly, S meets the definition of a subsidiary under IAS 27 *Consolidated and Separate Financial Statements*.
- The other shares in A and S not owned by P are widely held. The other shareholders in A and S are not related to P, A and S in any way.



- P sells its 40% interest in A to S in return for cash consideration.
- P retains significant influence in A although its effective interest decreases to 28%.
- The other 12% has effectively been acquired by the 30% non-controlling interest in S.



Should IAS 28 or IAS 27 be applied in this fact pattern?

View A – A gain or loss should be recognized to the extent there has been a transfer outside of the group

In the financial statements of P, a partial disposal of an associate has occurred and, therefore, paragraph 19A of IAS 28 is applicable. The transfer has resulted in the group giving up a portion of its ownership in A to third parties (i.e., the 30% non-controlling interest in S), and it is appropriate to recognize a gain or loss on the portion of the investment "sold" to third parties (i.e., 30% x 40% = 12%).

View B – No gain or loss should be recognized because this is a group transaction

The transaction represents a group transaction between P and S and, therefore, paragraph 20 of IAS 27 is the appropriate guidance. Paragraph 20 of IAS 27 requires that profits and losses from intra-group transactions are eliminated in full. There is no economic substance in the sale of an associate to a subsidiary (whether partially or wholly owned) and, therefore, the recognition of any gain or loss would be inappropriate.

View C – A gain or loss should be recognized on the disposal of the entire 40%

The transfer has resulted in the parent giving up its direct interest in the associate to its subsidiary concurrent with a partial disposal of the associate to an unrelated third party. Accordingly, any gain or loss on the former interest held in the associate should be recognized in full and the interest "retained" through the subsidiary should be treated as a new investment.

View D – The transaction constitutes a transaction between the parent and non-controlling interest and should be treated as a capital transaction

Paragraph 30 of IAS 27 considers a reduction in the ownership interest in a subsidiary without loss of control to be a transaction between owners that is treated as a capital transaction. An analogy to this guidance is appropriate because P effectively disposed of 12% (i.e., 40% - 28%) of A to the non-controlling interest, which represents a transaction between owners.

The Group's Discussion – Scenario 2

Group members observed that there was no support under IFRSs for View C. Group members noted that some may think View A applies because paragraph 19A of IAS 28 applies in Scenario 1. However, Group members observed that there was no support for View A in this scenario because IAS 27 clearly applies when a parent and subsidiary relationship exists. Some Group members expressed support for both View B and View D noting that neither view results in profit or loss recognition. Group members also observed that the issue becomes more complex in a fact pattern involving shares instead of cash consideration.

Some Group members observed that there is no conflict between the requirements of IAS 27 and IAS 28 in this scenario because a parent/subsidiary relationship exists and, as a result, paragraph

20 of IAS 27 is applicable. The Group concluded that this issue should not be brought to the attention of the IFRS Interpretations Committee because diversity in practice is not expected to be significant.

IAS 36: Impairment Test of Provisional Goodwill Acquired during the Current Period

IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets* give an entity time (no longer than 12 months) to determine the fair value of net assets acquired in a business combination and allocate goodwill in the manner required by paragraph 80 of IAS 36. If the entity is able to allocate provisional goodwill in accordance with paragraph 80 of IAS 36, then it must do so. In that case, the entity tests the provisional goodwill for impairment in accordance with IAS 36.

Paragraph 85 of IAS 36 recognizes that, when the fair values of the identifiable assets acquired and the liabilities assumed are determined only provisionally at the end of the current period, it "might also not be possible to complete the allocation of goodwill."

The issue considered by the Group was whether impairment testing of provisional goodwill is required when it is not possible for the entity to complete the initial allocation of the provisional goodwill to cash-generating units (CGUs) or groups of CGUs in the manner required by paragraph 80 of IAS 36.

Fact Pattern:

Entity A:

- is in the restaurant business and operates a number of different branded corporate and franchise restaurants;
- completes its annual impairment test for goodwill from previous acquisitions on December 31;
- acquires Entity B on June 1, 2011 to broaden its brand within Canada;
- has not completed the acquisition accounting by December 31, 2011 (its financial year end) because the valuation of certain identifiable assets acquired is still in progress; and
- determines that indicators of goodwill impairment exist because the traffic in all of Entity A's restaurants, including those acquired from Entity B, has declined severely because of an economic recession.

View A – Not required to test for impairment

No impairment test is required when it is not possible to allocate provisional goodwill to CGUs or groups of CGUs, regardless of whether indicators of impairment are present.

View B – Required to test for impairment when there are indicators of impairment using another form of test

When an entity is not able to allocate goodwill to the CGUs reliably but there are indicators of impairment, the entity should perform an impairment test at the lowest level possible, even if that requires testing at the level of the entity.

The Group's Discussion

Group members observed that there was little or no support for View A. Group members noted that, in accordance with principles of IAS 36, an entity should perform an impairment test at the lowest level possible, even if that requires testing at the level of the entity. The Group concluded that the issue should not be brought to the attention of the IFRS Interpretations Committee because significantly divergent interpretations are not expected to emerge in practice.

Issues Submitted but Not Brought Forward

Issues submitted to the Group that meet all three of the Group's criteria are selected by the Group's Agenda Setting Committee for discussion at a Group meeting:

- Does the issue arise from the application of IFRSs in Canada?
- Is the issue widespread in Canada?
- Is there significant divergent practice, or the potential for significantly divergent practice, within Canada?

After this preliminary assessment of all issues submitted to the Group, some issues are not selected for a detailed discussion by the Group. This session allows the full membership to evaluate those issues against the Group's criteria and decide whether any of the issues should be discussed at a future meeting.

The Group considered two issues that were submitted but not brought forward.

IAS 32: Classification of Rights or Warrants Issued to a Limited Group

The Group received a submission requesting discussion of whether the exception added to paragraph 11 of IAS 32 *Financial Instruments: Presentation* in the *Classification of Rights Issues* amendment issued by the IASB in October 2009 can be applied to warrants issued in a different currency to a limited group (i.e., can those instruments be classified as equity in paragraph 11 of IAS 32?).

This issue was not selected for discussion by the Group because significantly divergent practice is not expected to emerge in Canada because paragraph 11 of IAS 32 states, in part, that: "…rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments." Paragraphs BC4J-BC4K further explains the IASB's decision to make this extremely narrow amendment.

IAS 11: Revenue Recognition for a Construction Contract with a Partial Leaseback

The Group received a submission requesting discussion of when profit and loss should be recognized for a partial leaseback that was negotiated as part of a construction contract accounted for using the percentage of completion method under IAS 11 *Construction Contracts*. The submission focused on the interaction between the requirements under IAS 11 and the guidance under IAS 17 *Leases* on sales and leasebacks and whether the requirements of these IFRSs are unclear when considered together. The request outlined a fact pattern involving a builder that enters into a contract with a customer to construct a customized asset over two years and a lease agreement that allows the builder to leaseback 10% of the asset's capacity. The submission requested that the Group discuss when, in this fact pattern, profit and loss should be recognized on the portion of the contract that will be leased back to the builder after the asset is constructed.

This issue was not selected for discussion by the Group because the circumstances described by the submitter are not expected to occur frequently in practice in Canada. Also, IAS 11 and IAS 17 will be applied for a limited time because the IASB is expected to issue the new standards on revenue and leases in 2012 or in early 2013.

UPDATES ON THE IFRS INTERPRETATIONS COMMITTEE'S OUTREACH REQUESTS AND OTHER ACTIVITIES

Outreach Requests from the IFRS Interpretations Committee Staff

The responsibilities of the Group include providing information on requests for input from the IASB, national standards setters or similar bodies regarding eligibility of issues for possible IFRS Interpretations Committee interpretations.

The AcSB staff circulate these outreach requests to Group members and ask for information about the prevalence of the issue in Canada and the level of diversity in practice that forms the basis for the AcSB staff response to the IFRS Interpretations Committee staff on each issue.

Since the Group's September 2011 meeting, the AcSB staff responded to six outreach requests and the IFRS Interpretations Committee continued its work on most of these issues at its January 2012 meeting:

- IAS 2 *Inventories* – long-term payments for inventory supply contracts;
- IAS 33 *Earnings per Share* – dividends on non-cumulative preference shares (two outreach requests);

- IAS 39 *Financial Instruments: Recognition and Measurement* – term-extending options;
- IAS 41 *Agriculture* – disclosure of the components of changes in fair value and associated valuation techniques; and
- IFRIC 12 *Service Concession Arrangements* – payments made by an operator in a service concession arrangement.

For further details, refer to the January 2012 IFRIC Update.

Changes to the IFRS Interpretations Committee's Strategy and Operations

The AcSB staff reported that the IFRS Foundation staff has provided an interim report on the Trustees' Review of the Efficiency and Effectiveness of the IFRS Interpretations Committee. The feedback from the Trustees' review included concerns over the scope of the Committee's activities and the appropriateness and application of the Committee's agenda criteria. In reflecting on this feedback, and after discussing it with the IASB, the Committee has identified areas for operational improvements and strategic matters that require attention. For further details, refer to agenda paper 3B for the Trustees' meeting on January 12, 2012.