

# IFRS Discussion Group

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## Report on the Public Meeting

June 12, 2014

*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 June 12, 2014 Meeting

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## ITEMS PRESENTED AND DISCUSSED AT THE JUNE MEETING

### IAS 23: Financial Liabilities Measured at Fair Value through Profit or Loss

Paragraph 18 of IAS 23 *Borrowing Costs* requires capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Borrowing costs are defined, in part, as interest expense calculated using the effective interest rate method as described in IAS 39 *Financial Instruments: Recognition and Measurement*. Paragraph 47 of IAS 39 allows for certain financial liabilities to be designated as at fair value through profit or loss.

IFRSs do not contain explicit guidance on how the capitalization of borrowing costs should be applied when an entity has elected to measure some or all of its financial liabilities at fair value through profit or loss.<sup>1</sup> Group members discussed the following two related issues:

#### ***Issue 1: Is capitalization of borrowing costs required for those borrowings that an entity has elected to measure at fair value through profit or loss?***

*View 1A – Yes, capitalization is required.*

Entities incur borrowing costs as defined by IAS 23 regardless of whether the entity measures its financial liabilities at amortized cost or elects fair value through profit or loss. The recognition of such incurred interest costs is incorporated as a component of the overall change in fair value. The accounting for borrowing costs should not be affected by whether or not an entity elects to measure its financial liabilities at fair value through profit or loss because interest costs are incurred and, thus, are in the scope of IAS 23 regardless of the method of accounting for the borrowing.

*View 1B – No, capitalization is not required.*

By designating financial liabilities as at fair value through profit or loss, the entity is not required to include these borrowings in the IAS 23 calculation of borrowing costs.

#### *The Group's Discussion*

Group members supported View 1A, that capitalization of borrowing costs is required for an entity electing to measure its otherwise qualifying borrowings at fair value through profit or loss, noting that measurement of the qualifying asset should not be affected by the classification of liabilities.

#### ***Issue 2: If the answer to Issue 1 is yes, how should the amount of borrowing costs eligible for capitalization be calculated?***

*View 2A – The calculation should be based on the guidance in paragraph 6(a) of IAS 23.*

The amount of borrowing costs capitalized should not change depending upon whether or not the borrowings are designated at fair value through profit or loss. For example, two companies with identical

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<sup>1</sup> For purposes of the discussion, it is assumed that all requirements for IAS 23 are otherwise met.

borrowings and qualifying expenditures should have the same borrowing costs capitalized and corresponding asset amounts reflected in their financial statements, even if one entity elects fair value through profit or loss for its borrowings and the other elects amortized cost. This view necessitates applying the effective interest method even though the measurement basis for the financial liabilities does not otherwise require such application.

*View 2B – Borrowing costs may be calculated on some other basis.*

Typically, entities have chosen to recognize certain borrowings at fair value through profit or loss and, therefore, not to apply the effective interest method because of practical challenges. Insistence upon calculating an effective interest rate creates an additional financial reporting burden. Therefore, another rationale and systematic basis for determining interest may be appropriate.

### *The Group's Discussion*

In principle, the Group supported View 2A, that when an entity elects to measure its financial liabilities at fair value through profit or loss, the effective interest method should be used to calculate the amount of borrowing costs eligible for capitalization. However, Group members acknowledged that some might argue otherwise due to the current lack of guidance in this area, or for practical considerations such as not wanting to bifurcate any embedded derivatives associated with the borrowings. One Group member observed that although this issue does not arise frequently, it could be of particular relevance to early development stage enterprises.

In light of the application issues that are arising, the Group recommended that both Issues 1 and 2 be discussed with the AcSB to determine whether they should be referred to the IASB or IFRS Interpretations Committee.

### **IAS 23: Impairment**

Capitalization of borrowing costs is based on qualifying expenditures for qualifying assets. IFRSs do not contain explicit guidance on the determination of qualifying expenditures subsequent to recognition of an impairment. Group members discussed whether or not qualifying expenditures should be reduced for impairment charges before applying the capitalization rate to determine the amount of borrowing costs eligible for capitalization.

*View A– Qualifying expenditures are reduced for impairment charges.*

After an impairment charge, the qualifying asset is reduced and, therefore, the amount of capitalized borrowing costs should be lower. Paragraph 8 of IAS 23 *Borrowing Costs* provides relevant guidance that the average carrying amount of the qualifying asset provides the basis for qualifying expenditures. Any impairment charges recognized (or reversed) by the entity would affect the carrying amount. Therefore, capitalized borrowing costs should be based on the average carrying amount.

If View B (below) is applied, a further impairment could arise immediately upon the capitalization of additional borrowing costs. View A has the same net impact as View B once the corresponding immediate impairment is recognized.

*View B – Qualifying expenditures exclude impairment charges.*

The amount of qualifying expenditures is not affected by an impairment because the two are unrelated. The borrowing costs were still incurred for the expenditure. The guidance on average carrying value in paragraph 18 of IAS 23 is applicable in “normal” circumstances. Use of the average carrying value is not appropriate after an impairment. Further:

- paragraphs 12 and 14 of IAS 23 focus on qualifying expenditures rather than an asset balance; and
- there is no requirement under either the impairment guidance (paragraph 16 of IAS 23) or the guidance on cessation of capitalization (paragraphs 22-25 of IAS 23) requiring an adjustment to capitalization after an impairment.

Although capitalization of borrowing costs based on View B may result in further impairments, View A and View B have very different consequences for the application of impairment reversal guidance under IAS 36 *Impairment of Assets* in subsequent periods.

*The Group’s Discussion*

One Group member stated the view of some (who would support View A) that it seems counterintuitive to capitalize interest on amounts that are no longer on an entity’s statement of financial position due to an impairment charge. Further, under US GAAP, when an item is written down, a new cost base is established. However, Group members agreed that IAS 23 is clear that the appropriate amount of qualifying expenditures on which to capitalize interest is the pre-impairment amount (*View B*). One Group member suggested that divergence from that guidance may be more prevalent in Canada than in other IFRS jurisdictions due to the impairment experiences of our resource sector.

Group members noted that there may be circumstances when there is not a significant difference between the two views shortly after the impairment (because the borrowing costs capitalized may simply result in a further impairment). In addition, the treatment selected could affect how an entity thinks about future impairment reversals.

The Group did not recommend any further action be taken on this issue, beyond suggesting to the AcSB that other avenues for raising Canadians’ awareness of the issue be explored.

**IAS 19: Shared-Risk Pension Plans**

Some jurisdictions have amended, or are planning to amend, legislation to allow retirement benefit arrangements described as “shared-risk” plans. For example, such plans have been developed in the New Brunswick and Nova Scotia public sectors and have recently been discussed in other provinces including Ontario. The [Public Sector Accounting Discussion Group](#) reviewed the accounting for these plans under public sector accounting standards at its [May 2014](#) meeting. These arrangements are also available for private sector entities. As a result, issues are arising on how to classify and account for shared-risk plans under IFRSs.

The fact pattern below was presented as an example in order to provide a basis for the Group’s discussion. However, there are a range of shared-risk plan structures that may differ from this sample fact pattern:

*Fact Pattern:*

- Funding is shared between the employees and the employer (for example, 10 per cent of salaries).
- Funding is set to meet certain risk management goals:
  - The primary risk management goal is at least a 97.5 per cent probability that the past base benefits at the end of each year will not be reduced over a 20-year period after taking into account the funding deficit recovery plan; and
  - The secondary risk management goal is that the expected escalated adjustment of the base benefit exceeds 75 per cent of the increase in consumer price index on average over a 20-year period (for plans that have a final average salary formula).
- If funding levels are not sufficient to meet the goals, a funding deficit recovery plan is mandated. Funding deficit recovery actions available are as follows:
  - an increase in contributions, not to exceed the greater of two per cent of earnings in respect of which contributions are made, and 25 per cent of the initial contribution rate;
  - a reduction or removal of ancillary benefits if they are not vested;
  - a reduction of future base benefits if the amount of the reduction does not exceed five per cent of the amount of the base benefits in effect immediately before the funding deficit recovery plan is implemented;
  - a reduction of remaining future base benefits; and
  - if the above actions are not sufficient, a reduction of past base benefits of members and former members (until the funded ratio returns to 105 per cent and the stated risk management goals are met).
- Upon termination or retirement of a member, actual benefits paid or payable to a member (i.e., “the termination value”) are calculated as the member’s share of the plan assets at the time of termination. Termination value is the greater of:
  - employee contributions plus interest (specified as the rate of return on the pension fund less administration expenses absorbed by the plan); and
  - the actuarial value of the base and ancillary benefits times the funded ratio.

This means that benefits payable to plan members cannot exceed funds available in the plan at any given point in time.

- Governance is provided by an independent board of trustees with an equal number of employee and employer representatives. Each trustee is mandated to act independently of the person who appointed him or her.
- The terms of the plan indicate that the sole obligation of persons making contributions under a shared-risk plan is limited to making or remitting, within the time prescribed by regulation, the contributions required under the plan text and the funding policy.

- In the case of a plan wind-up, plan members would be entitled to a wind-up value. The wind-up value is equal to:
  - funding policy liabilities of the benefits that each member or former member is entitled to multiplied by the funded ratio at that time.

Presuming a plan meeting the fact pattern described above is within the scope of IAS 19 *Employee Benefits*, the Group considered its classification in accordance with that standard (i.e., whether the plan is a defined benefit plan (*View A*) or a defined contribution plan (*View B*)).

*View A – The plan is a defined benefit plan.*

Under this view, the plan is not a defined contribution plan because the employer is exposed to potential variability in contributions. Paragraph 8 of IAS 19 defines a defined contribution plan as one where the entity makes a specific fixed contribution in each period, and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. When the employer has any residual risk that may require additional contributions, the plan is by definition a defined benefit plan.

*View B – The plan is a defined contribution plan.*

While contributions may vary in the future, the potential that employer contributions can increase is predetermined and capped. Benefit payments cannot exceed funds available in the plan and may be reduced if funding is insufficient. The employees collectively bear the risk that the plan assets will be sufficient. It may also be argued that, in substance, it is the employees that bear the actuarial and investment risks. Under this view, a defined benefit liability does not exist because the employer's sole obligation is to make the specified contributions.

*The Group's Discussion*

Group members observed that the economics of such plans, the magnitude of the associated potential risk that employer contributions would increase, the fact that there is no further obligation to pay the benefits after the initial increase in employer contributions (as would be expected for a defined benefit plan) and materiality, could lead some to argue that they should be classified as defined contribution plans. However, Group members supported View A, that shared-risk plans with the characteristics described in the fact pattern are defined benefit plans. Such plans do not meet the IAS 19 definition of a defined contribution plan (for example, contributions are not fixed and the employer has a legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all the employee benefits relating to current and prior periods). While the likelihood an employer would need to increase contributions may be low, that probability isn't relevant.

Group members agreed that their majority view raises a significant issue in terms of how to measure the associated liability. That measurement could be difficult, given the "tiering" of the required adjustments should there be a deficit in the plan.

Entities contemplating shared-risk plans are advised to seek advice before deciding on their classification, and to be aware of the measurement challenge described above.

The Group noted that shared-risk pension plans appear to be unique to Canadian markets. It also noted that the same fact pattern was discussed by the Public Sector Accounting Discussion Group at its May 2014 meeting. That Group also supported the view that plans meeting this fact pattern are defined benefit plans.

The Group did not recommend any further action be taken on this issue at this time.

### Non-GAAP and Additional GAAP Measures

Paragraph 55 of IAS 1 *Presentation of Financial Statements* requires that an entity present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. Paragraph 85 of IAS 1 requires similar presentation in the statement(s) of profit or loss and other comprehensive income. Paragraph 112(c) of IAS 1 requires that the notes provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them. Further:

- IAS 33 *Earnings per Share* permits disclosure of amounts per share using a reported component of the statement of comprehensive income other than the per share amounts required to be disclosed by IAS 33; and
- other IFRSs mandate that certain performance measures be disclosed (for example, IFRS 8 *Operating Segments* as it relates to segment profit and IAS 1 as it relates to capital management) although the composition of such performance measures is not defined by IFRSs; therefore, their meaning can vary among IFRS reporters.

These requirements have contributed to a variety of disclosure practices globally. In some jurisdictions, securities regulators have put in place specific regulatory guidance and/or requirements relating to these additional measures. For example, in Canada, the Canadian Securities Administrators issued CSA Staff Notice 52-306 (Revised) "Non-GAAP Financial Measures and Additional GAAP Measures." The Staff Notice defines an additional GAAP measure and provides disclosure guidance to help issuers meet their obligations under Canadian securities rules to ensure the information they disclose is not misleading.

Recent standard-setting activities are relevant to this topic. In March 2014, the IASB published its Exposure Draft, "Disclosure Initiative (Proposed amendments to IAS 1)." The Exposure Draft proposes narrow clarifying amendments to IAS 1 to address some of the concerns expressed about existing presentation and disclosure requirements, and to ensure entities are able to use judgment when preparing their financial statements. The Exposure Draft also attempts to further clarify the guidance around materiality as it pertains to disclosure.

Also, in October 2013, the IFRS Interpretations Committee received a request to clarify the application of some of the presentation requirements in IAS 1 in order to address what the submitter perceived as flexibility provided in the standard that could impair the comparability and understandability of financial statements. That submission was discussed at the Committee's May 2014 meeting. The [May 2014 IFRIC Update](#) explains why the Committee decided not to add this issue to its agenda.



The Group considered the IFRIC Update and the issue of what disclosures are appropriate when performance measures with meanings not explicitly defined in IFRSs are presented in IFRS-compliant financial statements, in order to ensure the information presented is relevant, a faithful representation, comparable and understandable. More specifically, should an entity consider the disclosure requirements proposed in the IASB's Exposure Draft when deciding on its disclosures for all such performance measures, or only those provided in accordance with paragraphs 55, 85 and 112(c) of IAS 1?

*View A – The Exposure Draft proposals relating to this issue are relevant for all performance measures included in IFRS financial statements that do not have a meaning specified in IFRSs that is common to all IFRS reporters.*

IAS 1 and the Exposure Draft proposals are premised on the general requirements in IAS 1 relating to faithful representation and fair presentation of an entity's financial position, financial performance and cash flows. Those requirements apply to all performance measures included in IFRS financial statements and not just those provided in accordance with paragraphs 55 and 85 of IAS 1. Even though the Exposure Draft proposals are not part of IFRSs at this point in time (and, therefore, should not be regarded as an interpretation of IAS 1), they may assist an entity in deciding what information it should present in accordance with that standard.

*View B – The Exposure Draft proposals relating to this issue are relevant only for those performance measures provided in accordance with paragraphs 55, 85 and 112(c) of IAS 1.*

When applied, View A provides users with worthwhile disclosures that may further assist their assessment of the financial position and financial performance of an entity. Therefore, entities are not discouraged from making such disclosures. However, the Exposure Draft proposals are most useful in instances when determining whether to disclose, or how to present items in the financial statements, requires a level of judgment. That is the case when complying with paragraphs 55, 85 and 112(c) of IAS 1, which necessarily involves an assessment by the entity of what is relevant to an understanding of its financial position and/or financial performance, and may call for certain explicit disclosures as suggested in the Exposure Draft.

For certain other common measures disclosed in an entity's financial statements, such as segment profit under IFRS 8 or capital management measures under paragraph 134 of IAS 1, less judgment is involved in deciding whether and, if so, what, to disclose. In these cases, IFRSs are explicit about the requirement to disclose these measures in an entity's financial statements (although the actual measures disclosed may not have a common IFRS definition across all IFRS reporters because they are often based on internal management measures) and are likely sufficient to achieve the fair presentation objectives of IAS 1.

### *The Group's Discussion*

The majority of Group members supported View B, that the disclosure proposals in the Exposure Draft are relevant only for those performance measures provided in accordance with paragraphs 55, 85 and 112(c) of IAS 1. Those Group members were concerned about the "clutter" that could otherwise result in an entity's financial statements, and thought View B provided the most practical approach.

Notwithstanding the majority view, some Group members thought that consideration of the Exposure Draft proposals could be helpful in arriving at relevant and helpful disclosures about specific measures, such as those relating to capital management.



Group members also made the following observations:

- Financial statements are a communications tool. Transparency and usefulness to readers, rather than volume, should be the objective. An example is debt covenant disclosure. Extensive disclosure of all covenants and the determination of an entity's compliance with them is challenging in terms of making this information helpful to financial statement users. This is due in part to the complexity involved and uncertainties related to how terms are defined. Such disclosure may be more relevant when a reporting issuer has violated, or is at risk of violating, its covenants. When a reporting issuer is safely onside with its covenants, consideration should be given to whether disclosure of that fact and the nature of the most important covenants may be sufficient.
- IFRS requirements relating to non-GAAP and additional GAAP measures should not be applied with a checklist mentality. The CSA representatives in attendance said the same was true for the Staff Notice. In both cases, judgment should be applied.
- Financial reporting in this area is evolving positively. The Exposure Draft proposals are intended as improvements. During the Group's discussion, the CSA representatives in attendance noted that once the proposals in the Exposure Draft are finalized, the CSA will consider any potential consequential amendments to the Staff Notice. Financial statement preparers are encouraged to keep up to date on future changes resulting from the Exposure Draft and any material issued by other bodies besides the IASB, including securities regulators.

As the Group's mandate relates to IFRSs and not securities regulations, views expressed during its discussion should not be interpreted as opinions on when and how to apply the guidance in the CSA's Staff Notice. However, Group members did observe that the Staff Notice appears to have the same "fair presentation and faithful representation" underpinnings as IAS 1 and the Exposure Draft proposals. Further, financial statements preparers and auditors have noted the general similarity between the practices suggested in the Staff Notice for the disclosure of additional GAAP measures and the proposed amendments to IAS 1, in terms of the additional line items, headings and subtotals in the statement of comprehensive income included in the Exposure Draft. As a result, elements of the Staff Notice may provide additional considerations for Canadian reporting issuers making judgments about whether a measure is an additional GAAP measure, and may also be relevant when considering the potential impact of the Exposure Draft proposals. In summary, together, the guidance in IAS 1 and other IFRSs, the Exposure Draft proposals and the Staff Notice comprise the current body of material to be considered by preparers when deciding on disclosures for non-GAAP and additional GAAP measures.

The Group did not recommend any further action be taken on this issue at this time. However, the Group noted that future developments in this area would provide the opportunity for further discussion on this topic at a later date.

### **IFRS 11: Accounting for Changes in Classification between Joint Ventures and Joint Operations**

IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures* are silent on how to account for a change in the contractual terms of a joint arrangement that results in a change in its classification (i.e., from a joint operation to a joint venture or vice versa). Such changes in classification

may have “knock-on” accounting effects, including on other comprehensive income, the capitalization of borrowing costs, the use of hedge accounting, and impairment timing and measurement.

**Fact Pattern:**

*Scenario 1 – Joint Operation to Joint Venture.*

Entity A and Entity B, two unrelated parties, enter into a joint arrangement that is structured through a separate vehicle, Entity C. Entities A and B are obligated to purchase all of the output produced by Entity C. Based on an analysis of the facts and circumstances related to the arrangement in accordance with paragraphs B29-B33 of IFRS 11, the arrangement is classified as a joint operation. Therefore, both entities recognize their share of the assets, liabilities, revenues and expenses in accordance with paragraph 20 of IFRS 11.

After operating for a substantial period of time under the original contractual arrangement, Entities A and B determine that the production capability of Entity C is well in excess of original expectations and there is a high demand for the product. Entities A and B decide to amend the terms of the contractual arrangement so that they are no longer obligated to purchase all of the output but, instead, the joint arrangement could sell unlimited amounts of the output to third parties. After the change in the contractual arrangement, the parties each continue to have joint control and the same level of ownership interest in the arrangement.

Paragraph 19 of IFRS 11 requires that if facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed. Based on the fact pattern above, Entity C is now classified as a joint venture because the activities of Entity C can no longer be said to be primarily designed for the provision of output to the Entities A or B and there are no other facts and circumstances that indicate that Entity C is a joint operation after this amendment.

In this scenario, no other changes were made to the contractual arrangement that would trigger a change in the classification of the joint arrangement (for example, a change to the legal form, relevant activities, etc.). In circumstances when such changes were made, judgment would be required to determine the appropriate accounting. These other circumstances are not considered in this fact pattern.

***Issue: How should the change in the classification of Entity C from a joint operation to a joint venture be accounted for in the financial statements of Entity A and Entity B?***

The change in classification from a joint operation to a joint venture is as a result of new facts and circumstances. Therefore, under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the change in classification would be treated like a change in accounting estimate and the new accounting applied prospectively. The Group considered whether this change triggers a remeasurement of the investment to fair value.

***View A – The change in the classification of the joint arrangement does not trigger a fair value remeasurement.***

While the contractual terms related to the interest held in Entity C have changed, the relationship between the entities and the joint arrangement is unchanged (i.e., the relationship is one of joint control before and after the change and the percentage ownership interest held by the parties before and after the

transaction is also unchanged). This is different from a situation involving the acquisition or loss of control, which would trigger a change in the measurement basis.

Entities A and B should account for this change at cost, which is equal to the carrying amount of the investment at the date of the amendment. Paragraph 10 of IAS 28 requires that, under the equity method, “on initial recognition the investment in an associate or joint venture is recognized at cost.” In the case at hand, cost could be considered to be the carrying amount of the pro-rata share of assets and liabilities immediately prior to the contract amendment because there was no increase or decrease in the invested amount in the joint arrangement as a result of this contractual change. Since the change in classification is a result of new facts and circumstances, the change should be made prospectively. Support for carrying value treatment can also be found by analogizing to the transitional guidance in Appendix C of IFRS 11.

This view of not remeasuring the investment is also consistent with the following:

- The principles of a common control transaction whereby a common control transaction is often measured at its carrying amount on the basis that there is no change in control over the assets. In the case at hand, there is no change in ownership interests and joint control is retained by each joint operator before and after the contract amendment. Recognition of a gain or loss due to a change in the contractual agreement would be the equivalent of permitting a revaluation of the assets and liabilities in the joint arrangement due to events solely within the control of the joint operators.
- Paragraph 24 of IAS 28, which requires no remeasurement when an associate becomes a joint venture and vice versa, even though such a change arguably has more economic significance (going from significant influence to joint control) than the change considered in the fact pattern at hand.

*View B1 – The change in the classification of the joint arrangement triggers a fair value remeasurement.*

The change in the classification of the joint arrangement is similar to a remeasurement event. While the parties have the same ownership interest and a joint control relationship before and after the change, the change results in an interest that is fundamentally different in its nature and required to be accounted for using the equity method after the contract amendment. That is, the change can be considered to be similar to the “disposal” of an interest in the assets and liabilities of a joint operation, followed by the “acquisition” of an interest in a joint venture. Paragraphs BC28 and BC 30 of IAS 28, regarding discontinuance of the use of the equity method, provide some relevant guidance on this point.

*View B2 – The change in classification of the joint arrangement triggers a fair value remeasurement only if the joint arrangement is a business.*

Remeasurement of the investment received is consistent with the IASB’s tentative decision, in its 2012 Exposure Draft, [“Sale or Contribution of Assets between an Investor and its Associate or Joint Venture,”](#) that if a subsidiary has been contributed to a joint venture or associate in exchange for an equity interest in that joint venture or associate, and that subsidiary qualifies as a business, a full gain or loss is recognized on the contribution. When this guidance is applied by analogy, and the joint arrangement qualifies as a business, then each entity is giving up its proportionate interest in the assets and liabilities of the joint operation in exchange for an equity interest in the joint venture. That supports remeasurement of the investment received at its fair value and recognition of a full gain or loss in profit or loss. In

contrast, if the assets contributed to the joint venture do not constitute a business, the gain or loss on contribution is recognized only to the extent of the interest of any unrelated investors in the joint venture (i.e., the portion of the gain recognized by the entity making the contribution is eliminated).

*View C – Remeasurement to fair value is an accounting policy choice.*

In the absence of IFRS guidance specifically addressing the issue, and the conflicts that arise from analogy to different pieces of existing (and proposed) guidance, entities have an accounting policy choice to remeasure to fair value or not. The accounting policy selected should be applied consistently to all similar transactions involving a change in classification from a joint operation to a joint venture.

### *The Group's Discussion*

Group members supported View A, that the change in classification from a joint operation to a joint venture does not trigger a fair value remeasurement, because the commercial substance of the arrangement has not changed. However, although they thought the technical arguments for View A were stronger, some Group members thought View B2 could not be ruled out completely.

One Group member observed that there are no known examples to date of View B being followed in Canada. Another Group member noted the impracticality, for many entities, of performing a fair value remeasurement, and suggested that the practicalities of View A aligned well with its conceptual merit.

The Group did not recommend any further action be taken on this issue at this time.

### *Scenario 2 – Joint Venture to Joint Operation.*

The reverse occurs for the same reasons (i.e., a change in the contractual arrangement now obligates the joint operators to purchase substantially all the output of the joint arrangement).

### ***Issue: How should the change in the classification of Entity C from a joint venture to a joint operation be accounted for in the financial statements of Entity A and Entity B?***

In this scenario, Entities A and B will be required to derecognize the net investment in Entity C that was accounted for using the equity method and recognize their share of assets and liabilities in relation to the joint operation at the date the change in classification occurs.

The Group considered how the entities should measure their share of the assets and liabilities relating to the joint arrangement at the date of the reclassification event.

*View A – The change in the classification of the joint arrangement does not trigger a fair value remeasurement.*

*View B1– The change in the classification of the joint arrangement triggers a fair value remeasurement.*

*View B2 – The change in the classification of the joint arrangement triggers a fair value remeasurement only if the joint arrangement is a business.*

*View C – Entities have an accounting policy choice between View A and View B (for the same reasons as in View C for Scenario 1).*

### *The Group's Discussion*

Group members' views on Scenario 2 (joint venture to joint operation) were the same as for Scenario 1 (joint operation to joint venture) for the same reasons. As with Scenario 1, the Group did not recommend any further action be taken on this issue at this time.

### **IAS 1: Opening Statement of Financial Position**

#### *IFRSs*

Paragraph 10 of IAS 1 *Presentation of Financial Statements* requires that a complete set of financial statements should comprise a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A-40D.

Paragraph 40A of IAS 1 further clarifies that the opening statement of financial position required by paragraph 10 should be presented when either the retrospective application or retrospective restatement, or the reclassification, has a material effect on the opening statement of financial position.

Finally, paragraph 40C of IAS 1 notes that when an entity is required to present an additional statement of financial position in accordance with paragraph 40A, it must disclose information such as the nature of the reclassification, the amount of each item or class of items that is reclassified, and the reason for the reclassification (unless it is impracticable to reclassify, in which case other disclosures are required). However, as a result of *Annual Improvements to IFRSs 2009-2011 Cycle*, issued by the IASB in May 2012, it was clarified that an entity need not present the related notes to the opening statement of financial position as at the beginning of the preceding period.

#### *Canadian Auditing Standards*

Canadian Auditing Standard (CAS) 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, deals with the auditor's responsibilities relating to comparative information in an audit of financial statements. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. Comparative information with amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

The standard states that when comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. However, CAS 710 does not dictate when an audit of comparative information is required, or what constitutes a separate financial statement that may require audit level assurance.

#### *Securities Legislation*

Subsection 4.1(1)(c)(ii) of National Instrument 51-102, *Continuous Disclosure Requirements*, requires a reporting issuer to file annual financial statements that include a statement of financial position as at the

beginning of the financial year immediately preceding the most recently completed financial year if the reporting issuer:

- applies an accounting policy retrospectively in its annual financial statements;
- makes a retrospective restatement of items in its annual financial statements; or
- reclassifies items in its annual financial statements.

Subsection 4.1(2) of National Instrument 51-102 requires annual financial statements filed under subsection (1) to be audited.

From a securities legislation point of view, there is no concept of materiality when interpreting the requirement to provide certain disclosures.

Section 3.3 of National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards*, requires that financial statements be audited in accordance with Canadian GAAS and be accompanied by an auditor's report that identifies all financial periods presented for which the auditor has issued an auditor's report.

***Issue: Is the opening statement of financial position a standalone financial statement?***

The form of the auditor's report depends on the reporting approach specified by law or regulation or in the terms of the engagement. For example, when financial statements are prepared in accordance with IFRSs, the auditor's report might only refer to the current period (a practice that is followed by many non-reporting issuers) or refer to all periods presented (a practice that is followed for reporting issuer audits filing in Canada, the US or both). Group members discussed the current two prevailing views below on whether, for purposes of reporting in accordance with the audit requirements under securities legislation, the opening statement of financial position is a financial statement of a separate period to which the introductory and opinion paragraphs of the auditor's report should make reference as being prepared in accordance with IFRSs.

*View A – No. The opening statement of financial position is not a standalone financial statement because of the absence of related notes.*

This view interprets paragraph 40B of IAS 1 to mean that the opening statement of financial position, being a statement as at the "beginning of the preceding period", does not represent the presentation of a financial period as contemplated by Section 3.3 of National Instrument 52-107. Instead, it forms part of the prior year comparative financial statements. This interpretation is supported by the fact that the opening statement of financial position does not require related notes that, except for paragraph 40C of IAS 1, would otherwise be required.

Under this view, the opening statement of financial position is a disclosure requirement, even though it is presented on the face of the primary financial statements.

Although not formally communicated, it is understood that the view of the staff of the US Securities and Exchange Commission (SEC) is that the opening statement of financial position is not a comparative financial statement due to the absence of related notes. However, because the opening statement of financial position is part of the disclosure requirements of IFRSs, it is not marked "unaudited" (i.e., the

information is audited nonetheless because it forms part of the financial statements prepared in accordance with IFRSs). The opening statement of financial position should not be referred to in the introductory paragraph or the opinion paragraph of the audit report. If it is, then all related notes must also be included.

*View B – Yes, because the opening statement of financial position is identified as a financial statement (albeit no related notes are required under the accounting framework).*

This view interprets paragraph 10 of IAS 1 to mean that the opening statement of financial position is a discrete financial statement. Had the IASB concluded that the information was explanatory information and not a primary financial statement, the requirement to present information about opening balances would have required the information to be in the notes to the financial statements.

In addressing whether the opening statement of financial position represents a separate statement for a financial period, we can analogize to the guidance provided by the Auditing and Assurance Standards Board's (AASB) Task Force on Audit Reporting Implications of the New Canadian Auditing Standards. The Task Force noted that it is possible for financial statements prepared in accordance with an applicable financial reporting framework to not contain comparative information because of permissions in the financial reporting framework to omit that information (for example, paragraph 84 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that an entity is not required to include comparative information relating to disclosures the paragraph requires for each class of provision). The Task Force concluded that even though comparative financial statements are not required to include all comparative note disclosures, the financial statements were presented in accordance with the framework and the auditor may nevertheless be able to report on all periods presented without modification to the opinion.

Although not formally communicated, it is understood that the view of the securities regulators in Canada, through the Canadian Securities Administrators, is that the opening statement of financial position is a comparative statement that should be referred to in the introductory and opinion paragraph of the auditor's report, consistently and for all reporting issuers.

However, for reporting issuers filing in both Canada and the US that are audited in accordance with the standards of the Public Company Accounting Oversight Board ( PCAOB), the securities regulators in Canada will not object to audit reports that do not include a reference to the opening statement of financial position in the introductory or opinion paragraph. Note that under the reporting standards of the PCAOB, a change in accounting principle that has a material effect on the financial statements should be recognized in the auditor's report through the addition of an explanatory paragraph following the opinion paragraph.

### *The Group's Discussion*

Group members noted that this issue is not about whether the information contained in the opening statement of financial position is audited. The statement is audited along with all information included in an entity's financial statements. Rather, the issue at hand is whether the auditor's report should make reference to the opening statement of financial position as being prepared in accordance with IFRSs.

Group members observed that the issue:



- affects only jurisdictions, such as North America, in which auditors opine on multiple years rather than the current year only (as in Europe);
- creates difficulties for financial statement preparers, who may not have realized that they needed a “third” statement of financial position until the end of the year, and for their auditors, who had not envisaged it being part of their engagement; and
- is neither an accounting nor an auditing issue, but a practical issue of particular importance to Canadian cross-border filers and their auditors. The challenge arises from the need for an audit report that meets the requirements of both Canadian securities regulators, and the SEC and PCAOB. The views of these authoritative bodies differ, as described in detail under View A and View B above and summarized below:

	Provincial securities regulators	SEC/PCAOB*
Is the opening statement of financial position a standalone financial statement?	Yes	No
Should it be identified in the introductory paragraph of the audit report?	Yes**	No
Should the opinion paragraph of the audit report provide an opinion that includes the financial position as at the date of the opening statement of financial position?	Yes**	No
Are notes to the opening statement of financial position required?	No	No, unless the statement is identified in the introductory paragraph of the audit report, in which case all related notes should be included.
Should the audit report provide any explanatory information?	No	Yes. For changes in accounting policy, an explanatory paragraph should follow the opinion paragraph.

\* This column reflects the Group’s understanding of the views of these US bodies, those views having not been published.

\*\* The provincial securities regulators have confirmed that despite these views, for cross-border filers, they will not object to audit reports that do not include a reference to the opening statement of financial position in the introductory or opinion paragraph.

The majority of Group members did not express a preference for either View A or View B. Rather, Group members discussed the implications of the views summarized above for cross-border filers and their auditors who, it would appear, can choose from among the following options:

- Complete the audit under PCAOB standards and report under those standards only;
- Complete the audit under both PCAOB and CASs. Report based on the expectations of the provincial securities regulators, but include all notes to the opening statement of financial position to also satisfy PCAOB reporting standards;
- Complete the audit under both PCAOB and CASs. Report based on SEC/PCAOB expectations only, using the above-mentioned accommodation provided by the provincial securities regulators: or
- Complete the audit under both PCAOB and CASs and issue two separate reports. Group members observed that this option could be confusing to investors.

One Group member observed that attention to the views and options summarized above might avoid delays to a cross-border filer's financing and other transactions that could otherwise result if the audit report refers to an opening statement of financial position but the notes to that statement are not included.

The Group did not recommend any further action be taken on this issue at this time.

### **IFRS 3, IFRS 13 and IAS 37: Asset Retirement Obligations Assumed in a Business Combination or Asset Purchase**

Paragraph 18 of IFRS 3 *Business Combinations* requires an acquirer to measure all identifiable assets acquired and liabilities assumed at their acquisition date fair values. Although there are limited exceptions to this measurement principle, none relate to long-term provisions (such as decommissioning liabilities) assumed by the acquirer as part of a business combination. IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value. In accordance with paragraph 54 of IFRS 3, an acquirer subsequently measures and accounts for assets acquired and liabilities assumed in accordance with other applicable IFRSs for those items. In the case of long-term provisions assumed by the acquirer as part of a business combination, the applicable standard is IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Applying IFRS 13 to measure a provision assumed as part of a business combination at the acquisition date, and then IAS 37 subsequently, can result in a Day 2 adjustment to the value of the provision due to differences between the measurement guidance in those two IFRSs (including those pertaining to credit risk).

#### ***Fact Pattern:***

A decommissioning liability is assumed by the acquirer as part of a business combination. Applying IFRS 13, the acquirer determines the acquisition date fair value of the decommissioning liability to be \$100. The following day, the acquirer remeasures the liability under IAS 37, arriving at a value of \$120. Thus, the liability is increased by \$20.

There is diversity in views on the other side of the Day 2 accounting entry. Some take the view that the \$20 should go to profit or loss, while others would apply IFRIC 1 *Changes in Existing Decommissioning*,

*Restoration and Similar Liabilities* by analogy and increase the value of property, plant and equipment. More importantly, diversity in practice may exist with respect to the recognition of a Day 2 adjustment in the first place. Some entities may initially measure the decommissioning liability on the acquisition date using the measurement guidance in IAS 37 as a practical expedient even though this is not in accordance with IFRS 3. Accordingly, no adjustment is needed on Day 2. In the case at hand, this can result in the \$20 residing in goodwill instead of property, plant and equipment and, therefore, profit or loss of subsequent periods, even if the effect on future profit or loss is rarely material for the reasons discussed below.

### *The Group's Discussion*

Group members discussed:

- the likelihood of a material difference between the IFRS 13 fair value of an asset retirement obligation assumed in a business combination or asset purchase and the measurement value for that obligation resulting from the application of IAS 37; and
- whether there is diversity in practice.

On the first point, Group members observed that, based on their experience, there can be a material difference between the measurement values obtained by applying IFRS 13 versus IAS 37. A Group member noted that this difference is primarily due to the different treatment of credit risk between the two standards. Several Group members noted that the difference in measurement values was most important in circumstances when the business combination results in the recognition of a bargain purchase gain.

One Group member noted that significant measurement differences between IFRS 13 and IAS 37 were perhaps most likely to arise in oil and gas, and mining companies. For these companies, IFRS 13 requires that a profit element be factored into fair value estimates, whereas IAS 37 clearly states that the measurement value should reflect management's best estimate and many entities perform the remediation themselves.

From a technical perspective, Group members agreed that the accounting required by IFRS 3 for asset retirement obligations assumed in a business combination is clear (i.e., they should be measured at their acquisition date fair value). The Group's overall observation was that Day 2 complexities resulting from a strict application of IFRSs as currently worded point to possible flaws in the standards, which provide neither a scope nor measurement exception in IFRS 3 for this item. The Group noted that this issue preceded the adoption of IFRS 13 and, therefore, was not new. One Group member pointed out that uncertain income tax positions acquired in a business combination, which the Group has previously discussed, is another area involving Day 2 accounting complexities.

The Group was of the view that there is probably diversity in practice on this issue, both in Canada and globally, as a result of the different approaches taken by both preparers and valuers. Some Group members had the impression that some reporting issuers are not recognizing a Day 2 adjustment, but instead, are applying IAS 37 to determine the acquisition date value of asset retirement obligations assumed as part of a business combination. However, other preparers are applying a proper technical interpretation of the standards. The Group noted that the AcSB's [comment letter](#) to the IASB on that Board's post-implementation review of IFRS 3 took the view that there is diversity in practice regarding

the initial measurement of the asset retirement obligation and the recognition of a Day 2 adjustment, and offered to provide the IASB the results of the Group's discussion at its June 2014 meeting.

The treatment in practice of any Day 2 adjustments recognized by reporting issuers was less clear. Although one Group member was not aware of any instance where the adjustment was reflected in profit or loss at the outset, another knew of one such instance.

Group members noted that, in addition to the AcSB's comment letter, several audit firms made mention of this issue in their responses. Therefore, the Group recommended that this issue be monitored for any action on the IASB's part and, if it is not addressed, that it be recommended to the AcSB as an issue to be referred to the IASB or the IFRS Interpretations Committee.

## **UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP**

### **IFRIC 21: Levies – Property Taxes in Canada**

At its [February 2014](#) meeting, the Group had a follow-up discussion to its initial discussion of [December 2, 2013](#), on the potential implications of applying IFRIC 21 *Levies*. Financial statement preparers and auditors are reminded that the facts and circumstances deliberated at those meetings, as related to property taxes, are specific to Canadian jurisdictions. The Group's analyses of those facts and circumstances will not necessarily be applicable to other jurisdictions, including the US. Property tax legislation in other jurisdictions, including many municipalities in the US, may not have the same characteristics, terms and features deliberated by the Group that led to the views it has expressed thus far on this topic. Those views generally supported a ratable, rather than point-in-time, recognition of a liability to pay property taxes in Canadian jurisdictions. Preparers are encouraged to examine the details of the legislation in place in municipalities in which they own property, especially in locations outside Canada, because conclusions on the appropriate accounting treatment for property tax liabilities may differ according to the terms.

In addition, the Group reminds preparers that, as also discussed at its [February 2014](#) meeting, IFRIC 21 applies to more than property taxes. As a result, there could be other non-reciprocal payments enforced by government requiring consideration under IFRIC 21.

### **IFRS 11: Application Issues**

At its [September 2013](#) meeting, the Group discussed a number of application issues relating to IFRS 11 *Joint Arrangements*. At the Group's [December 2013](#) meeting, the AcSB staff reported that the IFRS Interpretations Committee considered a summary of the results of the outreach that was conducted on implementation issues arising from IFRS 11.

The Group observes the existence of some very significant joint arrangement structures in Canada, across a range of industries. The Group notes that there are ongoing discussions at the IFRS Interpretations Committee around a number of IFRS 11 implementation issues relating specifically to the determination of whether, based on the facts and circumstances, an arrangement is a joint operation or a joint venture. Entities that have previously made judgment calls in reaching a conclusion about whether a joint arrangement is a joint venture or a joint operation when structured through a separate entity are

encouraged to monitor those [discussions](#). The Group will also raise awareness, at future meetings, of any significant conclusions reached by the IFRS Interpretations Committee on matters that appear to be relevant in Canada.

### **Adoption of IFRSs by Investment Funds**

At its [December 2, 2013](#) meeting, the Group considered some of the transition concerns of investment entities that would be applying IFRSs for the first time. The mandatory IFRS changeover date for entities in this sector was January 1, 2014. As a result, many investment funds are currently preparing to issue, or have issued, their first interim financial reports under IFRSs. Entities are alerted to the fact that the IFRS Interpretations Committee has recently deliberated issues relating to the application of the consolidation exemption for investment entities. The IASB's June 2014 Exposure Draft, "[Investment Entities: Applying the Consolidation Exception \(Proposed amendments to IFRS 10 and IAS 28\)](#)," addresses several of those issues. The IFRS Interpretations Committee has issued a rejection notice regarding controlled investment entity subsidiaries established solely as tax advantageous structures. The Committee concluded that tax optimization on its own is not an investment-related service. Therefore, such subsidiaries are not consolidated.

Investment entities are advised to monitor follow-on discussions by both the IASB and the IFRS Interpretations Committee for further developments.