IFRS Discussion Group

Report on the Public Meeting

May 31, 2016

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board (AcSB) regarding the identification of 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. For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips.

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

Items Presented and Discussed at the May 31, 2016 Meeting

IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

IAS 1: Disclosures about an Assessment of Going Concern

IFRS 13: Definition of an Active Market

IFRS 2: Dividend Equivalent Shares

IFRS 2 and IFRS 3: Vested Share Options

IAS 19: Inflation Rate

Update on Previous Items Discussed by the Group

IAS 32 and 39: Changes to Convertible Debt

IAS 21: Determining Functional Currency

IAS 10: Subsequent Events Relating to Uncertain Tax Positions

IAS 16: Capitalization of Costs

Other Matters

IFRS 15: Revenue from Contracts with Customers

IFRS 10 and IFRS 11: Accounting for Loss of Control Transactions

IFRS 3 and IFRS 11: Remeasurement of Previously Held Interests – Obtaining Control or Joint Control in a Joint Operation that Constitutes a Business

IFRS 9 and IAS 28: Measurement of Long-term Interests

IAS 36: Recoverable Amount and Carrying Amount of a Cash-generating Unit

ITEMS PRESENTED AND DISCUSSED AT THE MAY MEETING

IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

The Group discussed the issue, "IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase" at its meeting on September 11, 2014.

The issue was whether the contingent consideration payable in an asset purchase when the assets do not constitute a business should be:

- measured at fair value and recorded as part of the cost of purchase (View A);
- measured and recorded at some other point (for example, when the conditions associated with the contingency are met) (View B); or
- measured in accordance with an accounting policy choice because IFRS guidance in unclear (View C).

At that time, the Group expressed diverse views on this issue. Many Group members thought the accounting is dependent on the fact pattern and that no view could be discounted outright. The Group noted that the IFRS Interpretations Committee discussed the accounting for variable payments for asset purchases in 2013 and recommended that the IASB undertake a narrow-scope project to address the issue. The IASB decided it would reconsider the issue after the proposals in the IASB's Exposure Draft, "Leases" had been redeliberated. Therefore, the Group recommended that the AcSB monitor the IASB's consideration of this issue in relation to its Leases project.

Subsequent to the Group's discussion, the IFRS Interpretations Committee revisited this issue at its September 2015 and November 2015 meetings. The IFRS Interpretations Committee considered two possible views with respect to initial recognition of variable payments:

- Apply the leasing principles. This application would include variable payments based on an index or rate in the initial measurement of a liability for acquisition of an asset and exclude all other variable payments, such as those dependent on the future activity of the purchaser. This view shared some similarities to View B that the Group discussed at its September 2014 meeting.
- Apply the business combination principles. This application would result in the purchase-date fair value of all variable payments being recognized as part of the consideration transferred in exchange for the asset(s). This view is similar to View A discussed by the Group at its September 2014 meeting.

In the March 2016 agenda decision, the IFRS Interpretations Committee noted that it could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be

recognized as a liability on the purchase date of the asset or only when that activity is performed. The IFRS Interpretations Committee was also unable to reach a consensus on how the purchaser measures a liability for such variable payments. In addition, during the IASB's deliberations on its Leases project, the Board did not conclude whether these variable payments meet the definition of a liability. As a result, it is not clear whether an analogy to the principles of the Leases project could be made. The IFRS Interpretations Committee concluded that the IASB should address the accounting for variable payments comprehensively.

The Group's Discussion

Group members discussed whether the deliberations of the IFRS Interpretations Committee subsequent to September 2014 would change their previous views on the accounting for contingent consideration in an asset purchase.

Some Group members noted that views on this issue have not changed in practice and international deliberations furthered the possibility of an accounting policy choice (View C). However, the Group noted that before reaching this conclusion, preparers should carefully examine whether the facts and circumstances of an entity's situation are similar to the fact pattern discussed by the IFRS Interpretations Committee. Preparers should also consider whether the arrangement is in the scope of other standards that could require the recognition of a liability (for example, IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*).

One Group member observed that there is tension between the recognition and measurement concepts, and that it is important to determine first whether there is something to recognize. Another Group member noted that the IFRS Interpretations Committee discussion focused more on determining whether there is a financial liability and moved away from analogizing to the principles in IFRS 3 *Business Combinations*. A question was raised on where the debit entry would be recorded if an entity chooses not to recognize the contingent consideration in an asset purchase but subsequently pays for it. One Group member suggested that a future agenda item could be to discuss various scenarios involving a contingent consideration payable.

Overall, the Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 1: Disclosures about an Assessment of Going Concern

The IFRS Interpretations Committee received a submission from the International Auditing and Assurance Standards Board (IAASB) in 2012, requesting clarification about the disclosures required for material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The IAASB noted that the guidance was unclear as to when the disclosures required by paragraph 25 of IAS 1 *Presentation of Financial Statements* should be provided, and what information should be disclosed about such material uncertainties.

The IFRS Interpretations Committee proposed to the IASB that it should make a narrow-scope amendment to change the disclosure requirements in IAS 1 in response to this issue. The IASB

acknowledged that information about going concern is important to investors. Information about the events and conditions that cast significant doubt upon an entity's ability to continue as a going concern is also useful to investors and creditors. However, many IASB members were concerned about the sensitive nature of these disclosures and some were concerned that the act of disclosure could become a self-fulfilling prophecy. As such, the IASB decided not to proceed with a narrow-scope amendment to IAS 1.

Consequently, the IFRS Interpretations Committee removed the topic from its agenda. In its July 2014 agenda decision, the IFRS Interpretations Committee discussed a situation in which management has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The IFRS Interpretations Committee observed that "in the circumstances discussed, the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern."

Fact Pattern

An entity is currently experiencing significant financial difficulties and is considering whether there are material uncertainties related to events or conditions that may cast significant doubt upon its ability to continue as a going concern. Management has several plans to mitigate the effect of these material uncertainties, including private equity-based financings, negotiations to defer certain debt repayments and cost reduction initiatives.

Management considered all the relevant information, including the feasibility and effectiveness of management's mitigation plans, and concluded that there are no material uncertainties that would require disclosure in accordance with paragraph 25 of IAS 1. This fact pattern is intended to depict a "close call" situation and in reaching this conclusion, management applied significant judgment.

Issue: Given that management applied significant judgment in reaching its conclusion, would further disclosures of the significant judgment be required by paragraph 122 of IAS 1?

View A – Disclosure of the significant judgment applied in reaching its conclusion is not required under paragraph 122 of IAS 1.

Under this view, the disclosures required by paragraph 122 of IAS 1 are significant judgments made by management in applying an entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Proponents of this view note that the disclosures of judgments about material uncertainties do not relate to applying an entity's accounting policies as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and do not have a significant effect on the amounts recognized in the financial statements.

View B – Disclosure of the significant judgment applied in reaching the conclusion is required under paragraph 122 of IAS 1.

Under this view, the disclosures required by paragraph 122 of IAS 1 would apply because management applied significant judgment in determining and assessing the events or conditions around the material uncertainty and the mitigating factors in reaching its conclusion.

Proponents of this view note that, in some circumstances, the judgment applied could have a significant effect on the amounts recognized in the financial statements because if a different conclusion was reached, the amounts recognized in the financial statements would be on a liquidation basis, if appropriate.

The Group's Discussion

One Group member asked for an example of a mitigation plan. An example might be that management is looking to the private market to raise capital. A plan is in place but judgment is made on the probability of whether the entity would receive the required cash flows. This Group member observed that typically auditors would need persuasive evidence from the entity to avoid a going concern disclosure. If such evidence does not exist, a going concern note disclosure would be needed. Another Group member raised the question that, if disclosure on significant judgments in a close call situation is required, how explicit does the note disclosure have to be? Would having the information about the mitigation plans in the financial statements be sufficient so that a user can draw his or her own conclusion?

A few Group members approached the discussion from a user perspective. If an entity experiences financial difficulties, a user would like to see this information in the financial statements and look for an explanation as to why the entity continues to be a going concern, including the significant judgments made in the process. However, one Group member raised a question on the purpose of the additional disclosure and the intended message for the users in situations when management and the auditors are satisfied that a going concern disclosure is not needed. Disclosing significant judgments would seem more useful when there is a clear linkage to how the situation would affect the measurement of certain balances in the financial statements.

Another Group member pointed out that a broader issue is determining when an entity needs to have a going concern disclosure and that under IAS 1, an entity is a going concern unless management intends to liquidate, cease trading, or has no realistic alternative to do so. This Group member indicated support for View A in most circumstances.

The Canadian member of the IFRS Interpretations Committee clarified the intent of the international discussion. The agenda decision was intended to address a situation when an entity was facing significant financial difficulty and a material uncertainty exists about its ability to continue as a going concern. If management concluded that there are mitigating factors that dispelled the material uncertainty, it would be important to users that the significant judgments made in reaching such a conclusion are disclosed in the financial statements. Thus, the IFRS Interpretations Committee's intent was that View B applies in the situation described above because management applied significant judgment in determining and assessing the events or conditions around the material uncertainty and the

mitigating factors in reaching its conclusion. The reference to paragraph 122 of IAS 1 in the agenda decision was intended to be read broadly, as opposed to narrowly, with a focus on the significant judgments management made in a close call situation.

The Canadian Securities Administrators (CSA) observers at the meeting indicated that they understand the intent of the IFRS Interpretation Committee's discussion and consider that disclosures about the significant judgments made in a close call situation provide useful information to users. Regulators are emphasizing compliance with disclosure requirements for management discussion and analysis so that users are provided with information that will allow them to understand the entity's liquidity and plans. However, the CSA representatives observe differing levels of significant judgment disclosures for close call situations in the financial statements.

The Group recommended that the issue be discussed with the AcSB to determine whether it should be raised to the IASB or IFRS Interpretations Committee.

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

IFRS 13: Definition of an Active Market

IFRS 13 *Fair Value Measurement* defines fair value and establishes a framework for measuring fair value. This standard also establishes a fair value hierarchy based on the source of the inputs used to estimate fair value and contains the relevant disclosure requirements.

In Appendix A of IFRS 13, the following terms are defined as follows:

- Active market – A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Fair value –The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Paragraphs 76 to 90 of IFRS 13 establish a fair value hierarchy that categorizes the inputs to valuation techniques used to measure fair value into three levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). Valuation techniques used to measure fair value must maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The best indication of fair value is a quoted price in an active market.

Sometimes whether a market is active or not is self-evident. For example, an entity with shares quoted on an exchange (for example, the Toronto Stock Exchange) may have regular trading frequency and volume to provide pricing information on an ongoing basis. However, for entities in a start-up phase or a specific industry, their shares may have low frequency of trading and, in some cases, there could be no daily or monthly trading. Even if trading took place, the volume of shares traded could be low.

Fact Pattern

Entity A has a year-end reporting date of December 31, 2015. It classifies all investments in equity instruments as financial assets at fair value through profit or loss.

On July 1, 2015, Entity A acquired an investment of 125,000 shares in Entity B for a total cost of $10,000 (at $0.08 per share). Entity B is a start-up company listed on Exchange Y. The investment is not deemed to be an associate nor a subsidiary of Entity A.

Entity B has issued 5,000,000 ordinary shares. Entity B's closing price at December 31, 2015 on Exchange Y is $0.10 per share. Based on the December 31, 2015 closing price, Entity A's total investment in Entity B was $12,500 (at $0.10 per share). Shares of Entity B have traded on Exchange Y on four occasions during the year ended December 31, 2015 as follows:

- March 31, 2015 – 5,000 shares at $0.15 per share
- July 1, 2015 – 125,000 shares at $0.08 per share (i.e., Entity A's acquisition of the shares in Entity B)
- August 3, 2015 – 10,000 shares at $0.06 per share
- September 30, 2015 – 2,000 shares at $0.10 per share

Entity B has not issued any shares by way of a private placement or any other means during the year ended December 31, 2015.

Issue 1: What are some common characteristics used in assessing whether an investment is traded in an active market?

The definition of an active market requires an entity to consider both the frequency of trades and the volume of those trades.

In assessing frequency and volume of trades, an entity may consider whether:

- there are recent buy-sell transactions;
- there has been a significant decline in the frequency and volume of transactions from what it previously experienced;
- the last trade date is close to the measurement date in order to determine whether current information is available; or
- there is a significant movement or variance in the quoted prices over a period of time.

The Group's Discussion

Group members made various observations regarding other characteristics that entities can look at in assessing whether the investment is traded in an active market. For example, an entity could look at the bid-ask spread because generally if there are multiple participants in the market, the differential should be small. Also, an entity could consider economic indicators (for example, the price of oil) that could be correlated with the price of the security.

One Group member observed that entities could start with the presumption that an investment traded on an exchange is an active market, but then consider whether evidence exists to rebut that presumption. Another Group member pointed out that IFRS 13 is clear that assessing whether a market is active or inactive is not a function of the size of the investor's holding. The unit of account is the share and not the investment as a whole.

One representative from the Canadian Securities Administrators (CSA) noted that National Policy 12-203, *Cease Trade Orders for Continuous Disclosure Defaults*, also considers the concept of an active liquid market. Although this policy is in a different context from IFRS 13, the regulators have concluded that there is not an active liquid market for securities traded a few times in small volumes over a period of a month or two. Another CSA representative commented that generally they start with looking at the security and understanding the trading pattern, including when the last trade occurred, and the type of trade (for example, whether it is a forced trade or a related party trade). If trading is sporadic, an entity should consider whether there is a Level 2 input and if some sort of adjustment can be made for the illiquidity value, or whether a Level 3 valuation technique is needed.

Issue 2: If the last quoted price is considered not to be observable in an active market, what, if any, are the related fair value hierarchy implications?

View A – An entity is required to measure fair value using a valuation technique.

As the equity instrument is not quoted in an active market, the entity needs to use a valuation technique that might incorporate Level 2 or Level 3 inputs. Under this view, Entity A would look to use one or more of the following Level 2 inputs and adjust Entity B's exchange quoted price:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in markets that are not active;
- market-corroborated inputs (for example, an observable index); and/or
- broker quotes or pricing services (depending on how the information is developed).

View B – An entity is permitted to measure fair value using the last quoted price.

Paragraph 82 of IFRS 13 sets out Level 2 inputs and specifically refers to quoted prices for identical or similar assets or liabilities in markets that are not active. Under this view, when a current transaction can be observed in the same instrument, that price is used unless there is evidence that it does not represent fair value. Absent any observable evidence supporting a change in value, an entity is permitted to use the last quoted price as an indicative fair value, accompanied by a disclosure that the price is categorized within Level 2 of the fair value hierarchy.

Furthermore, proponents note that adjustments to the last quoted price would require significant assumptions and estimates. Hence, the last quoted price (even when the instrument is trading thinly or not at all) would be more indicative of the share's fair value than any other Level 2 or 3 valuation, especially when the equity instrument being valued is that of a start-up or similar type of entity.

The Group's Discussion

Group members noted that understanding why the market is assessed as being inactive is important. Some Group members thought it would be difficult to accept, or default to, the last quoted price if the entity reached the conclusion that the instrument is traded in an inactive market. An old value cannot be presumed to represent fair value, and thus, other valuation techniques should be used to derive a more reasonable estimate.

One Group member observed that IFRS 13 requires measuring fair value from a market participant's perspective. In this fact pattern, if an entity starts with the December 31, 2015 closing price of $0.10, further work is needed to understand how a market participant would view that price in order to determine whether any adjustments are needed.

A representative from the Canadian Securities Administrators observed that the inactive trade could be a useful reference point. Also, consideration should be given as to how long ago the last trade occurred relative to the measurement date, and whether using that price will produce a misleading result for investors. Valuation techniques produce estimates as well. Therefore, it is important to assess the reasonableness of the valuation techniques and the inputs used.

Some Group members noted that even if the December 31, 2015 closing price is determined to approximate its fair value based on an examination of all the facts and circumstances, such price is not a Level 1 measure under the fair value hierarchy because it has been concluded that the market is inactive.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IFRS 2: Dividend Equivalent Shares

Share-based payments could be structured in such a way that an equity-settled award entitles an employee to receive dividend equivalents during the vesting period to be paid in the form of incremental awards (i.e., not in cash).

Fact Pattern

- Dividend equivalents are forfeitable (i.e., they vest only if the conditions of the underlying award are met).
- Once those dividend equivalents awards are received, the employee is also entitled to dividend equivalents on those previously received dividend equivalent awards, without limit.
- The fair value of the dividend equivalents given to the employee is based on the cash equivalent amount of the dividends declared and paid by the entity on its issued and outstanding shares.

Issue 1: How should the dividend equivalents be accounted for in this fact pattern?

View 1A – Incorporate the dividend equivalents into the grant date fair value of the award.

Under this view, if the share-based payment holder receives incremental awards in lieu of dividends, he or she effectively has a dividend protection feature that will ensure compensation for any dividends declared during the vesting period.

This protection feature should be incorporated into the initial award's grant date fair value by setting the dividend rate to zero or using the unadjusted share price in valuing the award. As dividend equivalents are issued, inherently there is value to these additional awards. However, given the share price is based on the present value of future dividends, the value gained through the additional awards would be offset by the value lost in the original awards because of an equal change in the share price.

Proponents of this view note that no incremental value has been conferred upon the share-based payment holder, and as such, no additional compensation cost is recorded. This approach to the grant date fair value covers all dividend equivalents, including those received on previously issued dividend equivalent awards. This approach would be in line with paragraph 16 of IFRS 2 *Share-based Payment* in that all the terms and conditions are considered in the grant date fair value of the award.

View 1B – Recognize the dividend equivalents separately.

Proponents of this view analogize to the reload guidance in paragraph 22 of IFRS 2. Each award of shares is accounted for only when awarded. A reload feature provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price. If the above guidance is applied to the issuance of dividend equivalents, the original grant date fair value would exclude the future dividend stream. Incremental compensation costs would be recognized when each incremental award is issued.

The Group's Discussion

Group members supported the view to incorporate the dividend equivalents into the grant date fair value of the award (View 1A) for the reasons outlined above.

Issue 2: Regardless of the approach selected for Issue 1, when a dividend equivalent award is issued, what additional accounting entry, if any, is required?

View 2A – Record an entry within equity.

Proponents of this view analogize to the treatment of a cash dividend (as a cash dividend of equivalent amount could have been paid in lieu of the additional award). When the dividend equivalent awards are issued, a debit is recorded to retained earnings and a credit is recorded to equity, likely to the same account credited periodically when the compensation cost is recorded. The amount of the entry should be determined with reference to the cash value of dividends declared.

View 2B – No entry required.

Unlike the payment of a cash dividend, the issuance of dividend equivalent awards does not require an entry. Under IFRSs, there is no guidance addressing the classification and presentation of items within

shareholders' equity. An entity could choose not to reflect the non-cash dividend payment because it affects two items within shareholders' equity.

The Group's Discussion

Group members noted there is no guidance in IFRSs on accounting for a non-cash dividend on a stock compensation arrangement, nor on the classification of component items within the statement of changes in equity. A few Group members commented that both views have merit. Some Group members expressed a preference to reflect the transaction by recording an entry to equity because a dividend has been declared (View 2A). Other Group members observed that since a cash payment has not been made and the net assets of the entity have not decreased, no adjustment is required (View 2B).

Group members observed that preparers should also consider what disclosures are required to communicate information about the dividend equivalent award to users of the financial statements (for example, disclosing the non-cash transaction and the general terms and conditions of the share-based payment arrangement).

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IFRS 2 and IFRS 3: Vested Share Options

There is no explicit guidance in IFRS 3 *Business Combinations* on the treatment of equity-settled share-based payment awards issued by an accounting acquiree that has been acquired in a reverse acquisition.

According to paragraphs B21 and B22 of IFRS 3, in a reverse acquisition, the consolidated financial statements are issued under the legal name of the accounting acquiree but described in the notes as a continuation of the financial statements of the accounting acquirer, with the exception of its legal capital. The equity balances recognized are those of the accounting acquirer (legal subsidiary) while the legal capital (i.e., the number of shares issued) is that of the accounting acquiree (legal parent).

Fact Pattern

Entity A, a non-listed company, is identified as the accounting acquirer in a reverse takeover transaction with Entity B, a listed entity. Both entities meet the definition of a business in accordance with IFRS 3.

Other information includes the following:

- After the transaction, Entity B changed its name to Combined Inc., which is the name of the resulting reporting issuer listed on the TSX Venture Exchange.
- The equity balances in the combined entity will relate to those of Entity A but the legal capital will be that of Entity B. The consolidated financial statements represent the continuation of the financial statements of Entity A except for its legal capital.

- On the acquisition date, Entity B has outstanding employee share options and warrants, which are fully vested, and were accounted for as equity-settled share-based payment transactions. These employee share options and warrants (also referred to as "awards") are included in equity at the time of the reverse acquisition.
- The share-based payment award documentation indicates that Entity B's obligation to honour the awards continue despite a change in control.
- The holders can exercise their awards in Combined Inc. after the acquisition.

Issue: How should the vested but outstanding share options and warrants held by employees of the accounting acquiree be accounted for by the accounting acquirer in the consolidated financial statements?

View A – The accounting acquirer should be viewed as replacing the vested but outstanding share options and warrants in the accounting acquiree with replacement awards.

Paragraph 30 of IFRS 3 states:

> "The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in IFRS 2 *Share-based Payment* at the acquisition date. (This IFRS refers to the result of that method as the 'market-based measure' of the share-based payment transaction.)"

Under this view, the acquirer calculates the market-based measure of both the replacement awards and those considered to be replaced at the acquisition date. Since the replaced awards are fully vested on the acquisition date, the value of the replaced awards on the acquisition date is included in the consideration paid for the accounting acquiree (i.e., the share-based payments are updated from the grant date to the acquisition date).

Paragraph B56 of IFRS 3 also states, in part:

> "Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with IFRS 2 *Share-based Payment*. If the acquirer replaces the acquiree awards, either all or a portion of the market-based measure of the acquirer's replacement awards shall be included in measuring the consideration transferred in the business combination. Paragraphs B57-B62 provide guidance on how to allocate the market-based measure."

Therefore, the consideration that the accounting acquirer paid for the accounting acquiree should be adjusted with the market-based measure of the acquirer's replacement awards at the acquisition date according to IFRS 2. In this fact pattern, there would be no post-acquisition expense because the consideration is adjusted with the total revised market-based measure of the awards on the acquisition date.

View B – No values relating to the vested but outstanding share options should be recorded in the consolidated financial statements.

Paragraph 33 of IFRS 3 states, in part:

> "In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the equity interests transferred."

Since Entity B is a listed entity, the fair value of its equity interest is more reliably measureable than those of Entity A. Therefore, the consideration would have reflected the value of the employee share options and warrants in reference to Entity B's equity interest. Thus, the accounting acquirer is not required to make any further adjustments to the consideration.

In contrast to View A, proponents of this view note that it is inappropriate to conclude that the accounting acquirer is issuing replacement awards on the basis that Entity B changed its legal name to Combined Inc.

View C – Recognize an equity reserve for the vested but outstanding share options and warrants with an adjustment to goodwill.

Proponents of this view note that the consideration calculated in accordance with paragraph 33 of IFRS 3 would have reflected the value of the employee share options and warrants. Thus, the consideration does not need to be adjusted. However, in considering the guidance in paragraph 30 of IFRS 3, the equity of Combined Inc. should include a value for the vested but outstanding share options and warrants.

The rationale is that the accounting acquirer can be viewed as having assumed the accounting acquiree's contractual obligation. Therefore, the employee share options and warrants should be revalued based on the market-based measure according to IFRS 2 at the acquisition date and included in equity with a corresponding debit to goodwill.

View D – Recognize a reserve for the vested but outstanding warrants and options as a reallocation of the acquirer's equity (i.e., no effect on consideration or goodwill).

This view is similar to View C, except that proponents consider a reallocation between equity balances (i.e., retained earnings or contributed surplus) to be more appropriate than an adjustment to goodwill.

The Group's Discussion

There were some clarifying questions on the views presented. A few Group members expressed views that shared similarities to View A but approached the discussion by considering the difference between a business combination and a non-business combination situation (i.e., when the assets of the accounting acquiree do not constitute a business).

In a business combination situation, the guidance on the exchange for options in IFRS 3 would apply. Although in this fact pattern, it is a reverse takeover and there is no legal exchange occurring, the transaction is akin to an exchange from an accounting perspective. This fact pattern would likely not result in a charge to profit or loss after the acquisition because the awards were fully vested at the date of acquisition so there would be no future service period after the reverse takeover transaction.

The accounting for a non-business combination was also discussed for comparison even though it was outside the fact pattern. In a non-business combination situation when the legal parent is a shell entity, IFRS 2 would apply. IFRS 2 would require the accounting acquirer to look at the fair value of the goods and services it received to determine the value of the share consideration that is given in the exchange. If the fair value of the goods and services cannot be reliably determined, then the notional share consideration given by the accounting acquirer would be used. This approach could result in a similar outcome to the accounting under IFRS 3, but preparers should use caution in assuming the model under IFRS 3 is identical to that in IFRS 2.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

IAS 19: Inflation Rate

IAS 19 *Employee Benefits* requires financial assumptions to be based on market expectations. An explicit inflation assumption may be required to measure the defined benefit obligation of a pension plan. Two common approaches used by Canadian pension plan sponsors to determine an inflation assumption are based on:

- a break-even inflation rate (Approach A); or
- long-term considerations, including the Bank of Canada target inflation range (Approach B).

Since the transition to IFRSs in Canada, the above two approaches have generally produced similar results until recent years.

Question: Which of the two approaches are appropriate in determining the inflation rate assumption for measuring the defined benefit obligation of a pension plan under IAS 19?

Approach A – A break-even inflation rate.

This approach considers that a market-based inflation expectation can be determined by looking at the difference in yields of two long-term Government of Canada bonds (i.e., one nominal and one real-return bond). The difference in yields can be viewed as the market's implicit expectation of the long-term rate of inflation in Canada.

Proponents of this approach note that there are several advantages with Approach A. This approach is based on current market prices of bonds at the measurement date so that inflation expectations of market participants, investors and bond issuers are reflected in the bond yields. In addition, Government of Canada bonds are traded frequently in significant volumes and daily yields on

benchmarks of these bonds are easily accessible by the public. Furthermore, proponents think that this approach is consistent with other IFRS jurisdictions that commonly provide inflation indexation (for example, the United Kingdom).

There are some disadvantages with Approach A. For example, during times of market turbulence, the existence of liquidity premiums may create a distortion in the break-even inflation rate measure because investors may demand a higher yield to compensate for the risk they bear. Also, the duration of bond indices that are available to determine this measure may not be sufficiently long to be representative of the duration of obligations. There are also other factors that could affect the prices for nominal and real-return bonds (for example, de-risking of pension plans).

Approach B – Long-term considerations, including the Bank of Canada target inflation range.

This approach determines an inflation assumption using a forecast approach by considering the Bank of Canada's policy to estimate long-term inflation. Proponents of this approach often set the long-term inflation assumption to correspond to the midpoint (i.e., two per cent) of the Bank of Canada's target range of one to three per cent.

Proponents of this approach note that there are several advantages with Approach B. The Bank of Canada has been successful in meeting the inflation target in recent years and is able to apply monetary policy tools to help meet the inflation target in the future. This measure is also not distorted by changes in liquidity premiums.

There are some concerns with Approach B. For example, the Bank of Canada inflation target rate is not a market-based measure and may not be aligned with the long-term views of market participants, investors and bond issuers. A forecast approach for the inflation rate could also create an inconsistency with the discount rate assumption as the discount rate is based on market yields for high-quality corporate bonds. Further, the ability of the Bank of Canada to meet inflation targets could be challenged by external factors such as global economic conditions.

The Group's Discussion

The Group noted that this issue is primarily relevant for indexed plans. Group members asked several questions, including whether:

- there is a predominant actuarial practice in Canada;
- the adjustments to Approach A resulted in a more converged or diverged inflation rate with Approach B; and
- entities performed a reconciliation between the two approaches.

The presenter observed that practice is mixed and that both approaches have been used in Canada. Generally, it is challenging to come up with a precise basis point for adjusting the yield differential (Approach A), but adjustments in Canada have tended to bring the inflation rate closer to the target inflation rate of two percent. However, the adjustment is dependent on market conditions. It is not common to see management perform a reconciliation between the two approaches. However,

differences between the two approaches could be indicating that market participants think that the inflation rate will not be near the target inflation rate.

One Group member thought that paragraph 76 of IAS 19 provides some flexibility because actuarial assumptions are based on an entity's best estimates. Financial assumptions are based on market expectations, with the discount rate specifically referring to market yields. Therefore, the Bank of Canada's target inflation rate could be viewed as some form of market expectation, albeit not necessarily market yields. Another Group member has seen more of a survey-based approach (i.e., Approach B) where respondents like economists make many observations of the market, and they generally do not veer from the Bank of Canada target inflation rate of two per cent. However, consideration should be given as to when the survey is conducted in relation to the measurement date of the defined benefit obligation to ensure the information is sufficiently current.

One Group member observed that given a more precise discount rate is computed at each measurement date, it seems counterintuitive to use a fixed inflation rate. It would seem more appropriate to find a more precise inflation rate that is inherent in the discount rates to achieve consistency in the actuarial assumptions. Another Group member noted that while Approach B is commonly seen in practice, the break-even inflation rate should be considered in applying Approach B as it could provide additional useful information on determining an appropriate inflation rate estimate, particularly given the changes to the bond yields in the current market conditions.

The Group noted that the IASB has a research project on post-employment benefits (including pensions) and pointed out that more guidance on determining assumptions like the inflation rate would be helpful.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 32 and 39: Changes to Convertible Debt

At its December 2015 meeting, the Group recommended that this issue be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee. The AcSB staff reported that the AcSB discussed the issue at its March 2016 meeting and observed that while this issue may highlight potential improvements to the requirements in IFRS 9 *Financial Instruments*, the fact pattern discussed is not resulting in significant diversity in practice. The AcSB decided not to raise this issue internationally because it would not meet the IFRS Interpretations Committee's agenda criteria. The AcSB directed the staff to continue monitoring for other potential application issues related to modification or exchange of debt instruments.

IAS 21: Determining Functional Currency

At its September 2015 meeting, the Group recommended that this issue be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee. The AcSB staff reported that the AcSB discussed the issue at its November 2015 meeting and directed the staff to

undertake further limited research. At its March 2016 meeting, the AcSB considered the results of the research and noted that this issue was not widespread among Canadian entities. The AcSB decided not to raise the issue internationally because it would not meet the IFRS Interpretations Committee's agenda criteria and confirmed no further action is needed at its May 2016 meeting.

IAS 10: Subsequent Events Relating to Uncertain Tax Positions

At its June 2013 meeting, the Group discussed this issue and noted that although some diversity appears to exist in practice, the Group decided not to recommend the issue be brought forward internationally. The reason is that the issue is intertwined with the broader issue regarding whether uncertain tax positions are within the scope of IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for which the IASB is aware of the need for guidance.

The AcSB staff reported that the AcSB decided to raise this issue through its January 2016 response letter to the IFRS Interpretations Committee's Draft IFRIC Interpretation, "Uncertainty over Income Tax Treatments." The AcSB staff is monitoring the project and will update the Group on any future developments.

IAS 16: Capitalization of Costs

At the May 2015 meeting, the AcSB staff reported that the Group's discussion on the issue was shared with the staff of the IFRS Interpretations Committee around how to consider the phrase "to be capable of operating in the manner intended by management." The input was considered as part of the IFRS Interpretations Committee's deliberations on an issue it received regarding the accounting for proceeds and costs of testing of property, plant and equipment. The IFRS Interpretations Committee continued its discussions over several meetings.

At the May 2016 meeting, the AcSB staff provided an update on this issue to the Group. The AcSB staff noted that the IFRS Interpretations Committee tentatively decided at its March 2016 meeting to propose a narrow-scope amendment to IAS 16 *Property, Plant and Equipment*. The amendment would prohibit the deduction of proceeds from selling items produced from the cost of property, plant and equipment before it is capable of operating as intended by management. However, the IFRS Interpretations Committee decided not to address the issue of when the property, plant and equipment is capable of operating in the manner intended by management because this issue was beyond the scope of the submitter's issue.

The Group members briefly discussed the tentative direction of the IFRS Interpretations Committee and noted that the proposed amendments would have a significant effect on practice in Canada, particularly for entities in the extractive industries. Group members were concerned that the aspect of cost allocation has not been addressed by the IFRS Interpretations Committee. If the proceeds from selling items produced before the asset is available for use were recognized in profit or loss, the profit margin of an entity would be distorted because corresponding costs such as depreciation expense may not be captured in the same period. Further, the implications that the proposed amendment would have on other standards such as IAS 2 *Inventories* and IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* need to be further considered.

One Group member also pointed out that the proposed amendment could open up a number of other conceptual issues, including the underlying issue of when the asset is capable of operating in the manner intended by management. For example, small mining entities may show profitability in the testing period by recognizing proceeds before commercial production with negligible related costs being recognized. However, in reality, these entities may never reach a commercial production stage or alternatively may never be profitable.

The Group noted that the underlying issue of determining when an asset is capable of operating as intended by management is particularly relevant to the issues discussed such as ongoing cost allocation and commencement of depreciation expense. Since the underlying issue continues to be a challenge in practice and will become even more of an issue if the proposed amendments to IAS 16 materialize, the Group recommended that the AcSB discuss whether a submission is needed to the IFRS Interpretations Committee to highlight this matter.

OTHER MATTERS

IFRS 15: Revenue from Contracts with Customers

In April 2016, the IASB issued amendments to IFRS 15 *Revenue from Contracts with Customers* that clarify some requirements and provide additional transition relief for companies that are implementing the new standard. The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments arise because of discussions of the IASB/FASB Joint Transition Resource Group. The amendments have the same effective date as the standard, which is January 1, 2018.

IFRS 10 and IFRS 11: Accounting for Loss of Control Transactions

At its March 2016 meeting, the IFRS Interpretations Committee discussed whether an entity should remeasure its retained interest in the assets and liabilities of a joint operation when the entity loses control of an asset or group of assets. The IFRS Interpretations Committee tentatively concluded that it will not add this issue to its agenda on the basis that the underlying issue is similar to the conflict between IAS 28 *Investments in Associates and Joint Ventures* and IFRS 10 *Consolidated Financial Statements* that arises on the sale or contribution of assets to an associate or joint venture. The IASB decided to defer and address the conflict in those standards as part of its research project on equity method of accounting. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period on June 6, 2016 if they have any concerns with the tentative agenda decision.

IFRS 3 and IFRS 11: Remeasurement of Previously Held Interests – Obtaining Control or Joint Control in a Joint Operation that Constitutes a Business

An Exposure Draft is expected to be published in June 2016 to propose narrow-scope amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements*.[1] The proposed amendments will aim

[1] Subsequent to the meeting, the IASB issued the Exposure Draft, Definition of a Business and Accounting for Previously Held Interests, to clarify both the definition of a business and how to account for previously held interests.

to clarify remeasurement requirements on gaining control of a joint operation that constitutes a business and a change of interests resulting in a party to a joint operation obtaining joint control in a joint operation that constitutes a business. Stakeholders were encouraged to follow the status of the project.

IFRS 9 and IAS 28: Measurement of Long-term Interests

The IFRS Interpretations Committee received a request relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*. The issue relates to whether an entity applies IFRS 9, IAS 28 or a combination of both standards to the measurement of long-term interests in an associate or a joint venture. The long-term interests, in substance, form part of the net investment in the associate or joint venture, but the equity method is not applied. The Committee noted that there are diverse reporting methods applied and that the issue is widespread. It has tentatively decided to develop a draft Interpretation that would explain how to account for the long-term interests. Stakeholders were encouraged to follow the status of this issue.

IAS 36: Recoverable Amount and Carrying Amount of a Cash-generating Unit

At the December 2015 meeting, the AcSB staff reported that the IFRS Interpretations Committee received a request to clarify the application of paragraph 78 of IAS 36 *Impairment of Assets* and published a tentative agenda decision in November 2015 to explain the rationale for not adding the issue on its agenda.

The AcSB staff reported that it had responded to this tentative agenda decision, referring to the Group's discussion on a similar issue regarding the application of paragraph 78 of IAS 36 and recommending wording changes to the rationale. The IFRS Interpretations Committee made some of the suggested wording changes and finalized its agenda decision on this issue in March 2016.

(For opening remarks, including other matters, listen to the audio clip).