

# IFRS<sup>®</sup> Discussion Group

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## Report on the Public Meeting

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October 5, 2017

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

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

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

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

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## ITEMS PRESENTED AND DISCUSSED AT THE OCTOBER MEETING

### IFRS 9, IFRS 15 and IAS 34: Disclosing the Effects of Adopting New Standards

Entities adopting IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* on or after January 1, 2018 have raised questions around what they should be disclosing in their condensed interim financial statements after adopting these two new standards. The Group is asked to discuss five fact patterns relating to these questions.

The following guidance is relevant for Fact Patterns 1 and 2.

Paragraph 40A of IAS 1 *Presentation of Financial Statements* states:

- “An entity shall present a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:
- (a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
  - (b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the statement of financial position at the beginning of the preceding period.”

There is no explicit requirement for an opening statement of financial position in IAS 34 *Interim Financial Reporting*.

From a securities regulation perspective, Section 4.3(2)(d) in National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) indicates that an interim financial report must include:

- “in the following circumstances, a statement of financial position as at the beginning of the immediately preceding financial year:
- (i) the reporting issuer discloses in its interim financial report an unreserved statement of compliance with International Accounting Standard 34 *Interim Financial Reporting*, and

- (ii) the reporting issuer
  - (A) applies an accounting policy retrospectively in its interim financial report,
  - (B) makes a retrospective restatement of items in its interim financial report, or
  - (C) reclassifies items in its interim financial report;”

#### *Fact Pattern 1*

A reporting issuer with a calendar year-end prepares its Q1-2018 interim financial statements for the three months ending March 31, 2018. IAS 34 requires, among other things, a comparative statement of comprehensive income for the three months ending March 31, 2017 and a comparative statement of financial position as at the end of the preceding financial year (i.e., December 31, 2017).

The reporting issuer adopted IFRS 9 and IFRS 15 on January 1, 2018 on a retrospective basis with prior period comparatives restated. The effect on the opening statement of financial position as at January 1, 2017 is immaterial.

#### ***Issue 1: Is an opening statement of financial position as at January 1, 2017 required in the Q1-2018 interim financial statements?***

##### *The Group’s Discussion*

For the fact pattern described above, Group members noted that an opening statement of financial position is not required.

Representatives from the Canadian Securities Administrators (CSA) noted there is no materiality threshold in NI 51-102. Therefore, if the reporting issuer concluded that the effect of adopting the new standards on the opening statement of financial position as at January 1, 2017 is immaterial, it would be prudent to disclose this fact in the notes to the financial statements.

#### *Fact Pattern 2*

The facts and circumstances presented in Fact Pattern 1 are the same, except that the reporting issuer adopted IFRS 9 and IFRS 15 on January 1, 2018 on a retrospective basis without prior period comparatives restated (sometimes called the modified retrospective basis). The cumulative effect of initially adopting the new standards is recognized at January 1, 2018, and is material to the statement of financial position.

#### ***Issue 2: Is an opening statement of financial position as at January 1, 2018 required in the Q1-2018 interim financial statements?***

A point of consideration is that when the effect of adopting the new standards is recognized as an adjustment to opening equity as at January 1, 2018, the inclusion of an opening statement of financial position would not be meaningful to users. The disclosure of the nature of the adjustments recognized in opening equity as of January 1, 2018 is addressed in the transition disclosure requirements in the respective standards.

### *The Group's Discussion*

For the fact pattern described above, Group members noted that an opening statement of financial position is not required because that would negate the effect of adopting a modified retrospective approach for transition.

CSA representatives also noted that NI 51-102 does not require an opening statement of financial position in this situation.

### *Fact Pattern 3*

A reporting issuer prepares its Q1-2018 interim financial statements for the three months ending March 31, 2018. The reporting issuer adopts IFRS 9 on January 1, 2018, and is considering the extent of disclosures required when preparing its Q1-2018 interim financial statements.

### ***Issue 3: What financial instrument disclosure requirements apply to Q1-2018 interim financial statements prepared in accordance with IAS 34?***

Paragraph 16A(j) of IAS 34 sets out information to be disclosed for financial instruments. However, this paragraph was not amended as a result of the issuance of IFRS 9. Instead, IFRS 7 *Financial Instruments: Disclosures* was amended to include paragraphs 42I to 42S about disclosures to be provided upon the initial application of IFRS 9.

*View 3A – Only the disclosure requirements in paragraph 16A(j) of IAS 34 apply.*

Since IAS 34 was not amended for the changes made to IFRS 7 due to the issuance of IFRS 9, only the requirements in paragraph 16A(j) of IAS 34 apply to the first interim financial statements.

*View 3B – The disclosure requirements in paragraph 16A(j) of IAS 34 and the transition disclosures in paragraphs 42I to 42S of IFRS 7 apply.*

Paragraphs 42I to 42S of IFRS 7 do not make specific references to interim or annual reporting periods. Therefore, these disclosures apply to the first interim financial statements given their unique transitional status.

Further, although IAS 34 was not amended upon the issuance of IFRS 9, paragraph 15C of IAS 34 requires the following:

“Individual IFRSs provide guidance regarding disclosure requirements for many of the items listed in paragraph 15B. When an event or transaction is significant to an understanding of the changes in an entity’s financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.”

The disclosure requirements in paragraphs 42I to 42S of IFRS 7 would meet the above requirement such that users of interim financial statements can understand the impact of the initial adoption of IFRS 9 in the first interim period.

*View 3C – The disclosure requirements in paragraph 16A(j) of IAS 34 and all disclosure requirements in IFRS 7 apply.*

This view is incremental to View 3B. Given the significance of the changes in IFRS 9 compared to IAS 39, all disclosures under IFRS 7 are required in the first interim financial statements, in addition to specific transition disclosures required in paragraphs 42I to 42S of IFRS 7.

*View 3D – The level of disclosures provided in the first interim financial statements after adopting IFRS 9 varies depending on an entity's specific circumstances. Applying IAS 34, including paragraphs 15C and 16A(j), requires judgment in terms of determining what to disclose and when to disclose it.*

This view is consistent with the discussion at the January 11, 2013 meeting when the Group considered whether all the disclosures required by IFRS 12 *Disclosure of Interests in Other Entities* must be provided in the first interim financial statements after adopting IFRS 12.

At that meeting, Group members supported providing only the disclosures required by IAS 34, which include some of the IFRS 12 disclosures.

#### *The Group's Discussion*

The Group noted that it is important to provide users with the right level of information to help them understand the effects of adopting IFRS 9, particularly when an entity has selected the approach not to restate comparatives.

Several Group members supported the view that the disclosure requirements in paragraph 16A(j) of IAS 34 and the transition disclosures in paragraphs 42I to 42S of IFRS 7 apply (View 3B). Other Group members thought that an entity's starting point should be to look at the annual disclosure requirements pertaining to the significant event or transaction and use that as a model for preparing condensed interim disclosures. An entity should stand back and use judgment to assess what condensed disclosures are meaningful to users in order to comply with paragraph 15C of IAS 34. This approach means that an entity may start in View 3B but overlay the thought process described in View 3D.

A CSA representative emphasized the importance of the principle set out in paragraph 15C of IAS 34. Users need to be provided with information to help them understand the changes in an entity's financial position or performance since the last annual reporting period. IFRS 9 and IFRS 15 are major accounting standards, and therefore, the CSA representative expects to see robust disclosures in Q1-2018 to communicate the effects of adoption. The CSA representative echoed the Group's comments that entities should take materiality into consideration and exercise appropriate judgment in providing such relevant disclosures for users.

#### *Fact Pattern 4*

The facts and circumstances presented in Fact Pattern 3 are the same, except that the reporting issuer adopts IFRS 15 on January 1, 2018. The reporting issuer is considering the extent of disclosures required in relation to IFRS 15 when preparing the Q1-2018 interim financial statements.

***Issue 4: What revenue-related disclosure requirements apply to Q1-2018 interim financial statements prepared in accordance with IAS 34?***

Paragraph 16A(l) of IAS 34 was added as a result of the issuance of IFRS 15.

*View 4A – Only the disclosure requirements in paragraph 16A(l) of IAS 34 apply.*

IAS 34 is the relevant guidance for disclosures in the interim financial statements, and hence only the disclosure requirements in paragraph 16A(l) of IAS 34 apply.

*View 4B – The disclosure requirements in paragraph 16A(l) of IAS 34, and in paragraphs 110 to 129 and Appendix C of IFRS 15, apply.*

Proponents of this view look to the requirement in paragraph 15C of IAS 34 when assessing the extent of disclosures needed. Given the significance of the adoption of IFRS 15, all disclosures under IFRS 15 are required in the first interim financial statements.

Appendix C of IFRS 15 sets out specific disclosures relating to the transition to IFRS 15 (i.e., transition methods, practical expedients applied). Given their unique transitional status, these disclosures are also applicable to the first interim financial statements after adopting IFRS 15.

*View 4C – The level of disclosures provided in the first interim financial statements after adopting IFRS 15 varies depending on an entity's specific circumstances. Applying IAS 34, including paragraphs 15C and 16A(l), requires judgment in terms of determining what to disclose and when to disclose it.*

The rationale behind this view is the same as View 3D under Issue 3.

***The Group's Discussion***

Group members held the same views as expressed for Issue 3.

One CSA representative commented that from attending international meetings on this topic, it seems the disclosure expectations on a global level are consistent with the Group's discussion. An important point to note is that the extent of disclosures on adopting the new standards would vary by entity because information disclosed should be commensurate to the effect on the entity's business. Group members also noted that if an entity concludes the effect of adopting the new standards is immaterial, the entity needs to perform sufficient analysis to support that view.

On a separate note, another CSA representative commented that some entities have provided helpful disclosures indicating the directional effect of adopting the new standards. However, there is room to provide better information such as providing a discussion on the readiness to adopt the new standards and describing the work undertaken on any related system or internal control changes.

A few Group members briefly discussed whether the additional disclosure requirements in paragraph C8 of IFRS 15 apply to interim financial reporting periods. One Group member thought that the disclosure requirements for condensed interim financial statements are set out in IAS 34. However, in satisfying the requirements in paragraphs 15C and 16A(a) of IAS 34, an entity should look at the annual disclosure requirements as a model for preparing interim disclosures in order to provide sufficient information to help users understand the effects of adopting IFRS 15. As such,

paragraph C8 of IFRS 15 should be considered when the modified retrospective transition method is applied.

**Fact Pattern 5**

A reporting issuer prepares Q2-2018 and Q3-2018 interim financial statements for the six months and nine months ending June 30 and September 30, 2018, respectively. The reporting issuer adopts IFRS 9 and IFRS 15 on January 1, 2018, and is considering the extent of disclosures required relating to accounting policies in order to comply with the minimum disclosure requirements under IAS 34.

**Issue 5: When the reporting issuer's accounting policies under IFRS 9 and IFRS 15 have not changed relative to Q1-2018, can the reporting issuer cross-reference to the Q1-2018 interim financial statements when applying paragraph 16A(a) of IAS 34 in Q2 and Q3 of 2018?**

Paragraph 16A of IAS 34 specifies what additional information is required in the notes to the interim financial statements or elsewhere in the interim financial report. In particular, paragraph 16A(a) of IAS 34 requires:

“a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change.”

For a reporting issuer adopting IFRS 9 or IFRS 15 on January 1, 2018, the first discussion of new accounting policies and methods under the new standards is included in the Q1-2018 interim financial statements and not in the most recent annual financial statements (i.e., year ending December 31, 2017).

**View 5A – No.**

Paragraph 16A of IAS 34 allows for cross-referencing to “some other statement (such as management commentary or risk report) that is available to users of the financial statements on the same terms as the interim financial statements and at the same time.”

Proponents of this view note that the above does not contemplate an IAS 34 interim financial statement for an earlier interim period. Therefore, the reporting issuer's disclosures in Q1-2018 of new accounting policies and methods applied since the 2017 year-end financial statements are repeated in Q2-2018 and Q3-2018.

**View 5B – Yes.**

Unlike View 5A, proponents of this view think that the phrase “some other statement” is not restricted to items such as management commentary or risk reports as these are just examples rather than an exhaustive list. Provided that the Q1-2018 interim financial report is available to users on the same terms as the Q2-2018 and Q3-2018 interim financial reports and at the same time, cross-referencing is appropriate. These criteria are typically met when the earlier period interim financial report is in the public domain (e.g., available on SEDAR).



### *The Group's Discussion*

Some Group members supported View 5A, noting that the disclosures in Q1-2018 would be repeated and updated in Q2 and Q3 of 2018. Cross-referencing is generally used when referring to disclosures in the last annual report but not to interim financial reports.

Other Group members noted that View 5A is a conservative approach but find it difficult to justify that View 5B is not acceptable. This is particularly the case if the Q2 and Q3 disclosures are identical to the Q1 disclosures. A CSA representative did not object to the use of cross-referencing, but at the same time, entities should not assume cross-referencing is applicable in all circumstances. For example, if the disclosures are identical, it raises the question of how useful it is to duplicate the information from quarter to quarter. However, if there is a significant change in the quarter and including disclosures from Q1-2018 provides additional context, it might be helpful to users to have all the information in one place.

Overall, the Group's discussion on the five fact patterns raises awareness about the disclosures after adopting IFRS 9 and IFRS 15. No further action was recommended to the AcSB.

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

### **IFRS 16: Lease Term**

IFRS 16 *Leases* defines "lease term" as:

- "The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:
- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
  - (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option."

Paragraph 19 of IFRS 16 requires that when determining the lease term, an entity should consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise an option to extend, or not to exercise an option to terminate, the lease. Paragraph 20 of IFRS 16 requires an entity to reassess whether it is reasonably certain to exercise, or not to exercise, an option, when a significant event or a significant change in circumstances that is within the control of entity occurs and would affect its determination of the lease term.

The application of the term "reasonably certain" has historically been an area of divergent views under the existing lease standard, IAS 17 *Leases*. IFRS 16 addresses this issue by providing a general principle in paragraph 19, and including specific application guidance in paragraph B37 on the factors to consider when applying the concept of reasonably certain. These factors include the following:

- contractual terms and conditions for optional periods compared with market rates;
- significant leasehold improvements undertaken or expected to be undertaken;
- costs relating to the termination of the lease;



- the importance of the underlying asset to the lessee's operations; and
- conditionality associated with exercising the option and the likelihood that those conditions will exist.

Although there is no specific guidance on how to weigh the individual factors, paragraph B40 of IFRS 16 suggests that a lessee consider its past practice. A lessee should look at the time period over which it has typically used particular types of assets and its economic reasons for doing so to help assess whether it is reasonably certain to exercise, or not to exercise, an option.

The Group discussed five fact patterns to highlight some of the principles and application guidance in IFRS 16 on determining the lease term.

#### *Fact Pattern 1*

Retailer A has leased a store in a preferred high-density location for an initial non-cancellable term of five years, with an option to extend the lease by another five years at a premium rate compared to market rate at the end of the initial term. Past practice has demonstrated that, on average, Retailer A generally remains in a leased location for over 10 years.

***Issue 1: Should Retailer A apply past practice to weigh individual factors in evaluating the facts and circumstances that create economic incentive, in order to determine whether it is reasonably certain to exercise the extension option?***

#### *Analysis*

Retailer A should evaluate the benefit of the preferred location, although the economic incentive may not be readily determinable or easily quantifiable. For example, Retailer A should evaluate the benefits of a measurable cost saving under a new lease contract for another location in five years. However, Retailer A might be influenced by its past practice of staying in a location over 10 years, which could outweigh the potential cost savings despite paying above market-rate rents in years 6 to 10.

#### *The Group's Discussion*

Although Group members agreed that past practice should be considered to weigh individual factors, several observations were made. Group members noted that it is important to put past practice into context to determine whether such practice is applicable to the current situation and is predictive of future actions. For example, Retailer A's business objective may change over the years and technological advancements or changes in customer shopping behaviour may affect its future decision to continue leasing a physical location. Therefore, Retailer A should consider all factors to support its assessment of whether it would be reasonably certain to exercise the extension option, especially since the two factors in the fact pattern seem to offset each other.

#### *Fact Pattern 2*

Retailer B enters into a one-year warehouse lease that includes an automatic renewal clause. The clause states that the "agreement shall automatically renew for another one-year term unless the Lessee provides notice to the Lessor of its intent to terminate the agreement not less than 30 days before the end of the then-current term." Such leases are often referred to as perpetual lease

contracts. If the contract is terminated within the first 18 months, a penalty equal to 20 months' rent is due and payable. Assume the cost of terminating the lease within the first 18 months is significant.

***Issue 2: Is the following analysis appropriate in determining that the lessee is reasonably certain not to exercise the option to terminate early?***

*Analysis*

Paragraph B37(c) of IFRS 16 refers to considering costs relating to the termination of a lease, such as termination penalties, in determining the lease term. In this fact pattern, exercising the termination option within 18 months will trigger a significant penalty as the cost of terminating the lease exceeds the cost of not terminating the lease. Therefore, the term of the lease is 19 months, which includes the one-month notice period.

*The Group's Discussion*

Group members agreed with the above analysis.

*Fact Pattern 3*

Retailer C enters into a perpetual lease for a major new store location. The lease contract contains a termination option that can be exercised at any time by the lessor or the lessee (i.e., Retailer C). Retailer C has to provide six months' notice prior to terminating the lease and the lessor has to give 18 months' notice. A termination penalty of one-month rent applies if Retailer C terminates the contract. Retailer C has prepared budgets that reflect revenue from this new location for 60 months.

***Issue 3: Is the following analysis appropriate in determining that the minimum lease term is 18 months?***

*Analysis*

In determining the lease term and assessing the length of the non-cancellable period, an entity first considers the period for which the contract is enforceable. Paragraph B34 of IFRS 16 indicates that a lease is no longer enforceable when both the lessee and the lessor each have the right to terminate the lease without the permission from the other party with an insignificant penalty.

Retailer C takes into account that it has budgeted revenue from this location for 60 months. Retailer C has an option to terminate after six months without a significant economic penalty but the lessor can only exercise its right to terminate the lease contract after 18 months. Therefore, the earliest point in time that either party can exit without permission from the other is 18 months.

*The Group's Discussion*

Several Group members acknowledged what is stated in paragraph B34 of IFRS 16 but thought that the minimum lease term should be six months when looking at it from the lessee's perspective. They thought that if both the lessee and lessor have different periods for which the contract is enforceable, it is difficult to consider how the minimum lease term would be the longer period of the two. The lessee likely negotiated to put in an earlier termination option so it is possible that this option could be exercised. The Group leaned toward the lease term being a maximum, rather than a minimum, of 18 months because that is the point at which both parties can terminate the lease with

insignificant penalty. Entities are reminded to consider the guidance in paragraph B34 of IFRS 16 when determining the non-cancellable period of the lease.

#### *Fact Pattern 4*

An entity leases a building for a 10-year period with the option to extend for five years. At the commencement date, the entity concludes that it is not reasonably certain that it will exercise the extension option. The entity determines the lease term to be 10 years. After occupying the building for five years, the entity subleases the building to another party, and enters into a sublease contract for 10 years.

***Question 4: Is the event of entering into a sublease a circumstance that would result in the lessee reassessing its lease term?***

#### *Analysis*

The entity should consider whether the event is within its control, and if its previous assessment of whether it is reasonably certain to exercise the extension option changes.

#### *The Group's Discussion*

Group members agreed that the event described in Fact Pattern 4 would result in the lessee reassessing its lease term.

#### *Fact Pattern 5*

Security Co. is in the business of providing corporate security monitoring services to customers. Security Co. enters into a service contract with its customer to provide security monitoring services for 12 months. At the same time, it also enters into a lease contract with the customer to provide security equipment for 12 months. The security equipment must be returned at the end of the term. Both contracts have been combined and accounted for as a single contract.

Both contracts automatically renew for 12 months if the customer does not terminate them two months before the 12-month contract term expires. Security Co. cannot terminate the contract after 12 months. Past practice shows that 90 per cent of Security Co.'s customers do not terminate the contract before 12 months; after 24 months, 70 per cent of the customers remain under contract; and after 36 months, only 20 per cent of the customers remain under the contract.

***Issue 5: Should non-monetary factors be considered in determining the lease term?***

#### *Analysis*

In this fact pattern, there is no financial incentive for the customer to renew the contract for another 12 months, or to terminate the contract after 12 months because the contract would be renewed at the market rate. Non-monetary factors such as the time, effort and inconvenience to the customer to change service providers (e.g., returning the previous equipment and having new equipment installed) exist.

### *The Group's Discussion*

Group members noted that when considering whether there are facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, monetary factors are not the only consideration. Non-monetary factors should be taken into account because such factors could have cost implications. For example, if a lessee moves out of a primary location, there could be an economic effect on the overall business because sales may decline. One Group member noted that it is hard to identify something as purely non-monetary because there is usually a monetary or economic element to it (e.g., time has a cost to it).

The Group also raised additional points to consider when determining the lease term from the lessor's perspective. For example, it is inherently more difficult for a lessor to assess a lessee's action when considering if the lessee is reasonably certain to exercise an extension term. The lessor should also assess whether the population of leases are homogenous to ensure it is reasonable to apply termination percentages based on past practice. In addition, the lessor should consider whether the service contract component should be accounted for under IFRS 15 *Revenue from Contracts with Customers*.

In summary, it is important that entities put past practice into context and consider economic incentives more broadly to determine an appropriate lease term. The Group's discussion on the five fact patterns raises awareness of the principles in IFRS 16 when determining a lease term. No further action was recommended to the AcSB.

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

### **IFRS 16: Easement Granted by Regulatory Authority**

At its May 30, 2017 meeting, the Group discussed whether easements are within the scope of IFRS 16 *Leases* or IAS 38 *Intangible Assets*. The Group's discussion highlighted the need to understand all the rights and obligations in an agreement in order to determine which IFRS Standard applies.

#### *Fact Pattern*

A regulator authorizes the construction of an asset (e.g., transmission line or pipeline) that gives a regulated entity the right to build facilities on privately owned lands.

Sometimes the regulated entity is not required to compensate the landowner. However, at times the regulated entity is required to compensate the landowner for any damage to the land while constructing the asset. The compensation could be a one-time payment or periodic payments until the asset constructed is removed and the land is restored to its original condition.

***Issue 1: If a regulator authorizes an asset to be built above or below the privately owned land and the regulated entity is not required to compensate the landowner, is such an authorization an asset?***

*View 1A – Yes, and the asset should be assessed under IFRS 16.*

The regulator's authorization provides a legal right to access and build on the land.

Entities would look to IFRS 16 to determine the accounting for the easement on the basis that the regulator's authorization meets the definition of a lease (i.e., the authorization conveys the right to the entity to control the use of the land). Since no consideration is paid to the landowner, the asset would be valued at nil unless direct costs are incurred in obtaining the authorization.

Proponents of this view note that in a business combination, the legal right may be viewed as a valuable asset and could be recognized at fair value. Entities should also consider whether the arrangement constitutes a form of government assistance since the right is conveyed without having to compensate the landowner.

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

Since no consideration is paid to the landowner, there is no asset to record. The value of the right to construct may be a minor portion of the overall value of the asset being constructed.

#### *The Group's Discussion*

One Group member noted that in determining the accounting for such an arrangement, recognition should be considered separately from measurement. The entity should consider whether it has a substantive right that supports an asset being recognized as opposed to focus on whether there is payment for such a right. A substantive right should be reflected in the financial statements in order to be transparent and provide useful information to users. Other members observed that not all rights are recognized in the financial statements. Another Group member also noted that in an acquisition scenario, a buyer of the regulated entity would take into account this right, although acknowledging that the ability to value this right is a separate question.

***Issue 2: If a regulator authorizes an asset to be built above or below the privately owned land and the regulated entity is required to compensate the landowner, is such an authorization an asset?***

*View 2A – Yes, and the asset should be assessed under IFRS 16.*

This view is similar to View 1A. The asset is acquired in exchange for consideration paid to the landowner.

*View 2B – The authorization may not constitute an asset under IFRS 16.*

If the authorization is not within the scope of IFRS 16, another IFRS Standard may apply based on the rights and obligations conveyed by the regulator.

#### *The Group's Discussion*

A Group member noted that an entity should consider if there is an economic difference between making a lump-sum payment and a regular payment. A lump-sum payment could represent a prepaid asset when the entity is to consume the benefits over the period of the right. A regular payment may be more like a cost of doing business to generate revenue.

The Group noted that when determining the accounting for both Issues 1 and 2, it is first important to decide which IFRS Standard applies to the arrangement by assessing whether it is within the scope of IFRS 16. This thought process is consistent with the Group's discussion at its [May 30, 2017 meeting](#). If the arrangement does not meet the definition of a lease, then the entity

should consider if an intangible asset has been acquired. If the arrangement is neither within the scope of IFRS 16 nor IAS 38, then an entity should consider whether it is an executory arrangement. A payment made in advance of goods or services being received in an executory arrangement would likely be recognized as a prepaid asset. The arrangement should be disclosed in the financial statements when it is material to the entity's business.

The Group observed that the U.S. Financial Accounting Standards Board (FASB) has issued a [proposal](#) at the end of September 2017 to clarify that land easements should be evaluated under the new leases guidance in U.S. GAAP.<sup>1</sup>

A public observer who attended the Group's May 30, 2017 meeting submitted this easement-related fact pattern for the Group's consideration. The Group's discussion continues to raise awareness on this topic. No further action was recommended to the AcSB.

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

## **IFRS 15: Significant Financing Component**

The new revenue model in IFRS 15 *Revenue from Contracts with Customers* requires an entity to estimate the transaction price in a contract, which includes considering whether there is a significant financing component.

Paragraph 60 of IFRS 15 states, in part, the following:

"In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer."

However, when there is a change in the anticipated timing of the delivery of the goods or services, there is ambiguity around the subsequent accounting for the significant financing component.

An entity would also need to consider guidance in paragraph 18 of IFRS 15 to determine whether there has been a contract modification. It may be a matter of judgment to assess whether a change in timing of delivery is considered a change in the scope or price of a contract.

### ***Fact Pattern***

- An entity sells a large piece of equipment to a customer, to be delivered in two years, for \$10,000. The customer is required to pay the full amount upfront.
- The entity recognizes a contract liability when it receives the cash. The entity identifies that there is one performance obligation: the sale of the equipment, which is satisfied at a point in time upon delivery to the customer's premises.
- The entity has considered the guidance in paragraphs 60 to 65 of IFRS 15 and has concluded that the contract contains a significant financing component because of the length of time

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<sup>1</sup> The FASB's proposal also provides an optional transition expedient for land easements not previously assessed under the existing leases guidance in response to concerns about the costs and complexity of complying with the transition requirements of the new lease guidance.

between when the customer pays for the equipment and when the entity transfers control of the equipment to the customer.

- The entity concludes 5 per cent is an appropriate annual rate of interest for the two years, and adjusts the promised amount of consideration to accrete the contract liability by 5 per cent over the two-year period. Interest expense is recognized to reflect the financing received through the customer's advance payment. The total transaction price of \$11,025 ( $\$10,000 \times 1.05^2$ ) is recognized as revenue when the equipment is delivered and \$1,025 is recognized as financing expense over the two-year period.
- Six months after contract inception, the customer is facing delays in its project and asks to postpone the delivery date of the equipment by 12 months. There is no change to the consideration paid by the customer as a result of the extension of the contract duration.
- Paragraph 18 of IFRS 15 defines a contract modification as "a change in scope or price (or both) of a contract that is approved by the parties to the contract." In this fact pattern, the entity concludes that no contract modification exists, because neither the scope nor the price in the contract have been changed. The overall price in the contract remains \$10,000 (equal to the cash received), although the allocation of that price between the financing component and the transaction price to be recognized as revenue may change.

***Issue 1: Assuming that the change in timing of delivery is not considered a contract modification under IFRS 15, how should the significant financing component be accounted for?***

*View 1A – The entity should not adjust the discount rate and should continue to recognize interest expense over the extended delivery period. This results in a change to the transaction price and the amount of revenue recognized upon delivery.*

Paragraph 64 of IFRS 15 states, in part, that "[a]fter contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk)."

Proponents of this view note that the same discount rate of 5 per cent should be applied to calculate the financing component. This means the contract liability would be accreted up to \$11,576, which would then be recognized as revenue when the equipment is delivered. The cumulative interest expense recognized over three years would be \$1,576.

*View 1B – The entity should recognize revenue to reflect the cash price for the delivery of goods or services. Therefore, the discount rate should be adjusted to maintain a constant financing component and transaction price.*

Paragraph 61 of IFRS 15 states, in part, that:

"[t]he objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price)."



Proponents of this view note that the amount of the financing component and transaction price should remain the same as at inception such that the amount of revenue recognized reflects the cash price. Therefore, the discount rate should be adjusted to spread the interest expense over the extended period. In extreme circumstances when delivery is delayed for a significant period of time, application of View 1A could lead to a significant gross up between revenue and financing expense.

### *The Group's Discussion*

Group members expressed diverse views on this issue.

Some Group members noted that the entity should not adjust the discount rate because of the guidance in paragraph 64 of IFRS 15 (View 1A). Some Group members also noted that the entity has received an additional benefit of financing from holding the advance payment for another 12 months.

Other Group members focused on the objective stated in paragraph 61 of IFRS 15 that indicates the entity should recognize revenue to reflect the cash selling price (View 1B). One way of looking at paragraph 61 of IFRS 15 is that the transaction price would not be revised for the effect of the change in the expected period between payment and performance. Instead, the entity would revise the period over which it recognizes the difference between the transaction price and promised consideration as interest expense.

One Group member observed that there is no guidance in IFRS 15 for changes in transaction price relating to the significant financing component. The absence of guidance could suggest that the standard intended for maintaining a constant financing component and transaction price when there is no contract modification. Another Group member questioned whether there is economic benefit to the entity as a result of the customer's delay. If the entity finished producing the equipment, the cash received upfront would have been used such that there is no additional financing benefit derived from the customer's delay.

A concern was raised about changing the transaction price when an entity determined that there is no significant financing component at inception, but subsequently a significant financing component arises because of the delay in timing of delivery. A Group member noted that this situation may be addressed by the practical expedient described in paragraph 63 of IFRS 15. The practical expedient allows entities not to recognize a significant financing component at contract inception if the period between when the entity transfers the good or service and when the customer makes the payment is 12 months or less. This Group member's view is that once an entity determines that no significant financing component exists at inception, this determination would not change over the life of the contract unless there is a contract modification.

### ***Issue 2: If, instead, the change in timing of delivery is in conjunction with a contract modification under IFRS 15, how should the significant financing component be accounted for?***

Paragraph 20 of IFRS 15 is applicable when the scope of the contract increases because of the addition of promised goods or services that are distinct, and there is a concurrent change in the price of the contract that reflects the entity's stand-alone selling prices for the additional promised goods or services. In such a circumstance, the modification is accounted for as a separate contract.

In this case, the financing component for the original contract would not be affected by the contract modification.

Paragraph 21 of IFRS 15 is applicable for contract modifications not accounted for as a separate contract in accordance with paragraph 20 of IFRS 15. The accounting differs based on whether the remaining goods or services are:

- distinct from those transferred on or before the date of contract modification (i.e., a paragraph 21(a) modification); or
- not distinct such that there is only a single performance obligation that is partially satisfied as at the date of contract modification (i.e., a paragraph 21(b) modification).

***Issue 2(a): How should the significant financing component in a paragraph 21(a) modification be accounted for?***

For the fact pattern above, the remaining goods or services to be transferred are considered distinct because there has not been any transfer prior to the change in timing of delivery.

A paragraph 21(a) modification is accounted for as if it were a termination of the existing contract and the creation of a new contract. The consideration for the new contract is the sum of:

- (i) the consideration promised by the customer under the original contract that was included in the estimate of the original transaction price not yet recognized in revenue; and
- (ii) the consideration promised as part of the contract modification.

Based on how the consideration is calculated above, it could be viewed that the financing component in the original transaction price is unchanged and an additional financing component should be determined, potentially based on a new discount rate.

***Issue 2(b): How should the significant financing component in a paragraph 21(b) modification be accounted for?***

A paragraph 21(b) modification is accounted for as if it were part of the existing contract. The effect that the contract modification has on the transaction price, and on the entity's progress toward complete satisfaction of the performance obligation, is recognized as an adjustment to revenue at the date of modification (i.e., adjustment to revenue is made on a cumulative catch-up basis).

This accounting could be viewed to suggest that because the retrospective effect of the modification is accounted for on a cumulative catch-up basis, the discount rate applicable to the financing component should be reset. A new discount rate and financing component should be determined, taking into account the modifications to the contract.

***The Group's Discussion***

Group members agreed with the analysis presented above for Issue 2, which includes Issues 2(a) and 2(b).

The Group discussed whether a recommendation for action is needed to the AcSB on Issue 1 given the diverse views expressed and how this issue might exist in large scale projects (e.g., construction, mining and aerospace). The Group thought it would be premature to raise this issue

and suggested monitoring to understand how significant financing components are being accounted for in order to determine if a future action is needed.

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

## **IFRS 9: Own Use Contracts**

The scope of IFRS 9 *Financial Instruments* and of IAS 32 *Financial Instruments: Presentation* include guidance on when certain contracts to buy or sell a non-financial item (e.g., commodities or physical assets) are included or excluded from the requirements in IFRS 9.

Generally, a contract to buy or sell a non-financial item is not within the scope of IFRS 9. However, certain contracts to buy or sell a non-financial item may be required to be accounted for in accordance with IFRS 9 if those contracts can be settled:

- (a) net in cash or another financial instrument; or
- (b) by exchanging financial instruments, as if the contracts were financial instruments.

Paragraph 2.6 of IFRS 9 provides examples of ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments, some of which look at the entity's past practice.

The requirement to follow IFRS 9 for contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments is subject to a scope exception, commonly referred to as the "own use" scope exception. This exception is for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. Own use contracts are accounted for as normal sales or purchase contracts (i.e., executory contracts). IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* would apply if the own use contract became onerous.

Contracts falling into the own use scope exception are outside the scope of IFRS 9 and are not accounted for as derivatives. However, IFRS 9 introduced a fair value option for own use contracts. At the inception of a contract, an entity may make an irrevocable designation to measure an own use contract at fair value through profit or loss (FVTPL). However, such designation is only allowed if it eliminates or significantly reduces an accounting mismatch. On initial application of IFRS 9, an entity may designate own use contracts that exist at that date at FVTPL, but only if it designated all similar contracts based on paragraph 7.2.14A of IFRS 9.

### ***Fact Pattern 1***

Entity XYZ enters into a fixed-price forward contract to purchase a million kilograms of gold in accordance with its expected usage requirements. Entity XYZ intends to take delivery to meet its expected usage requirements. The contract does not require an initial upfront payment and is based on the price of gold to be settled at a future date. The contract permits Entity XYZ to take physical delivery of the gold at the end of 12 months or to pay or receive a net settlement in cash, based on the change in fair value of gold.

Entity XYZ has in the past entered into silver contracts for the purpose of generating a profit from short-term fluctuations in silver prices.

***Issue 1: How should the commodity arrangement be accounted for?***

***View 1A – The commodity arrangement is outside the scope of IFRS 9.***

From the fact pattern, no historical evidence exists for similar (gold) contracts settling net in cash. Therefore, the contract is outside the scope of IFRS 9 and should be accounted for as an executory contract (unless Entity XYZ irrevocably designates to measure the own use contract at FVTPL).

***View 1B – The commodity arrangement is within the scope of IFRS 9.***

Entity XYZ has historically entered into commodity contracts (for silver) with a view to selling the underlying within a short time after delivery for the purpose of generating a profit from short-term fluctuations in price. Therefore, Entity XYZ's intention to settle by taking physical delivery is not the prominent factor.

Entity XYZ can no longer use the own use exception and all commodity contracts, even for a different commodity, must be accounted for as derivative contracts under IFRS 9.

***View 1C – There is an accounting policy choice.***

The guidance in IFRS 9 does not specifically refer to the same or different commodities. As a result, Entity XYZ has a policy choice to apply either IFRS 9 derivative accounting or executory contract accounting.

***The Group's Discussion***

The Group members noted that the fact pattern did not indicate whether the previous experience with silver was similar to that of gold. Some Group members thought one would need to understand the business model better to make a more informed decision.

One Group member stated that each commodity is different and the entity would need to consider the facts and circumstances of how it uses each commodity. The fact that an entity has historically entered into commodity contracts (silver) with the view of selling the underlying does not automatically preclude the entity from using the exception for contracts in another commodity (gold).

The Group members agreed that there was no accounting policy choice with this issue. The entity needs to determine whether the own use exemption applies based on the facts and circumstances.

***Fact Pattern 2***

The facts are the same as Fact Pattern 1, except that Entity XYZ has in the past taken physical delivery of gold and within a short time, sold the gold for a profit as a result of short-term fluctuations in gold prices. The reason for selling the gold was due to an unexpected breakdown of its own production facility.

***Issue 2: How should the commodity arrangement be accounted for?***

***View 2A – The commodity arrangement is outside the scope of IFRS 9.***

While there is a pattern of past practice, the gold was only sold due to the unexpected breakdown of the production facility. This event could not have been foreseen at contract inception and would not taint the application of the own use exception.

The contract is accounted for as an executory contract (unless Entity XYZ irrevocably designates to measure the own use contract at FVTPL).

***View 2B – The commodity arrangement is within the scope of IFRS 9.***

There is evidence that Entity XYZ has in the past taken delivery of gold and sold it within a short time after delivery at a profit. As a result, this past practice taints the application of the own use exception even though, in this case, it was only undertaken due to the unexpected breakdown of the production facility.

Therefore, Entity XYZ can no longer use the own use exception and the new contract is accounted for as a derivative under IFRS 9.

***View 2C – There is an accounting policy choice.***

The guidance in IFRS 9 does not address whether past practice includes situations that are regular or unexpected. As a result, Entity XYZ has a policy choice to apply either IFRS 9 derivative accounting or executory contract accounting.

***The Group's Discussion***

The Group members thought it would be important to understand the reasons that lead to the entity settling the contract net. More information was needed to assess why the entity did not hold the gold until production had restarted. For example, the entity may have limited storage capacity that resulted in the sale, rather than selling the gold to make a profit. Group members also wanted to understand the likelihood of reoccurrence and future plans if there was another breakdown.

The Group members agreed that there was not an accounting policy choice as the entity would need to determine if the arrangement would be within scope of IFRS 9 based on the entity's facts and circumstances.

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](#)).

**IFRS 9: Classification of Financial Assets**

The Group considered the following fact patterns related to classification and measurement of financial assets under IFRS 9 *Financial Instruments*.

### *Fact Pattern 1*

Entity A has already adopted IFRS 9 (2014) to account for its financial instruments. Entity A acquires an investment in a financial asset whose contractual cash flows are considered to be solely payments of principal and interest as set out in IFRS 9 on initial recognition of the instrument. The instrument is held in a business model that is either “held to collect contractual cash flows” or “held to collect and sell” under IFRS 9. On initial recognition, the instrument qualifies to be recognized at amortized cost or at fair value through other comprehensive income (FVOCI).

After initial recognition, some of the terms of the financial asset are changed. There are no changes in the business model.

#### ***Issue 1: What are some approaches that an entity can use to determine whether a modification of a financial asset giving rise to a new instrument has occurred?***

It is important to determine whether a modification has occurred because it can have implications on the classification and measurement of the new instrument, and the recognition of the related impairment. Paragraphs B5.5.25 and B5.5.26 of IFRS 9 provides guidance related to modifications in the context of impairment.

#### ***View 1A – An entity could perform a quantitative assessment.***

Analogizing to the guidance on derecognition of financial liabilities, an entity could perform a quantitative analysis similar to the 10 per cent test described in paragraph B3.3.6 of IFRS 9.

A modification of a financial asset that breached the 10 per cent test should always result in the recognition of a new financial asset.

#### ***View 1B – An entity could develop an accounting policy that considers both quantitative and qualitative factors in the assessment.***

An entity should consider the nature of any quantitative and qualitative factors that could have given rise to the new financial asset.

#### ***The Group’s Discussion***

The Group members agreed that both the quantitative and qualitative factors should be considered. In completing the assessment, Group members noted that in the absence of guidance, analogizing to the most relevant piece of accounting literature might be appropriate. One Group member commented that consideration would need to be given to the full model and not only components of the model when analogizing to other guidance. In this circumstance, that literature would be relating to financial liabilities and the 10 per cent test in paragraph B3.3.6 of IFRS 9. Within that guidance, there is a requirement to look at qualitative factors in addition the quantitative factors. One Group member commented that an entity cannot qualitatively overcome a breach of the 10 per cent test but the entity would also need to consider all qualitative factors (e.g., due to a change in currency, addition of new security). Some of these factors might signify a modification.

Another Group member noted that an entity that has a large amount of small retail loans, for example, might perform the qualitative test prior to the quantitative test for practical reasons.

### *Fact Pattern 2*

An entity has a loan receivable outstanding as at January 1, 2018. The terms of the loan receivable were modified in 2016. Under its previous accounting policies applying IAS 39 *Financial Instruments: Recognition and Measurement*, the entity did not derecognize the modified loan receivable and recognize a new financial asset. However, under its accounting policy for assessing modifications of financial assets applying IFRS 9, the 2016 modification of the loan receivable would result in the conclusion that the original loan receivable should be derecognized and a new loan receivable recognized.

### ***Issue 2: Is consideration of modifications of financial assets before the date of initial application of IFRS 9 relevant at the entity's transition to IFRS 9?***

#### *View 2A – Yes.*

IFRS 9 is to be applied retrospectively, although prior periods need not be restated. As a result, the entity's new IFRS 9 accounting policies should be applied to the 2016 modification of the loan receivable.

Therefore, the 2016 modification date will be considered to be the inception of the instrument for purposes of assessing whether the loan's cash flows are solely payments of principal and interest. The 2016 modification date will also be considered as the inception date of the instrument for assessing whether the increase in the loan's credit risk is significant as at the date of initial application of IFRS 9.

#### *View 2B – No.*

IAS 39 did not deal explicitly with modifications of financial assets and the entity's prior policies were appropriate under that standard. The entity should rely on its prior assessment that the 2016 modification did not give rise to a new financial asset.

#### *View 2C – Either Yes or No.*

The transitional requirements of IFRS 9 are not clear on this point and either View 2A or View 2B would be acceptable, as long as the approach selected is applied consistently to all previously modified financial assets outstanding at January 1, 2018.

### *The Group's Discussion*

Group members agreed that conceptually IFRS 9 requires full retrospective application for assessing whether a financial asset meets the solely payments of principal and interest condition. In this scenario, an entity would need to apply its new policy retrospectively to assess whether a financial asset modification results in derecognition of the original financial asset and the recognition of a new financial asset that has been modified before the date of initial application of IFRS 9. However, in many circumstances, retrospective application for large pools of financial assets might be impracticable and require the use of hindsight, which is not permitted in retrospective applications.



### Fact Pattern 3

Paragraph B4.1.20 of IFRS 9 presents the concept of a “contractually linked” instrument as follows:

“In some types of transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.”

When a financial asset is contractually linked under IFRS 9, there are criteria that need to be met in order for the financial asset to be considered to have contractual cash flows that are solely payments of principal and interest. For example, Entity A holds a loan receivable from Entity B and this financial asset is considered to be a contractually linked instrument under IFRS 9. In order for Entity A to consider the loan receivable to have contractual cash flows that are solely payments of principal and interest, Entity B would have to hold only financial assets that themselves give rise to contractual cash flows that are solely payments of principal and interest.

***Issue 3: Presume Entity B has issued senior debt and that the loan receivable held by Entity A is the most subordinate of Entity B’s debt. Does the contractually linked guidance in IFRS 9 apply to the subordinated loan receivable held by Entity A?***

*View 3A– Yes.*

The subordination of Entity A’s loan receivable specifies the order of allocation of cash flows to Entity A and the other lenders as contemplated by paragraph B4.1.20 of IFRS 9.

*View 3B – No.*

Entity A has the legal right to be paid interest and principal on the loan receivable. Entity A’s claim related to its loan receivable may be limited to specified assets of Entity B. This may be considered to be a “non-recourse” financial asset in IFRS 9. Paragraph B4.1.17 provides the following guidance:

“However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 4.1.2(b) and 4.1.2A(b). In such situations, the creditor is required to assess (‘look through to’) the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.”

This guidance is not as restrictive as that for contractually linked instruments because the non-recourse guidance does not specify that the assets of Entity B would need to be financial assets whose cash flows are solely payments of principal and interest.

### *The Group's Discussion*

Group members observed that the single fact that subordination exists within a normal lending relationship between an operating entity and a lender does not cause an entity to have to consider the contractually linked guidance. The entity should also consider the non-recourse guidance.

Group members noted that careful consideration of the terms and conditions, in particular for subordinated financings, how cash flows would work and whether there is leverage, is needed.

One Group member also pointed out that the guidance within IFRS 9 on contractually linked instruments deals with fenced in pools of assets, which are typically in more structured entities, not in lending arrangements with operating entities. The guidance in IFRS 9 draws the distinction that if the borrower is an operating entity, it is most likely not within the contractually linked guidance. However, if the borrower is a structured entity, it needs to think about the contractually linked guidance when there is more than one tranche. In an operating entity, there might be commercial reasons why the entity has subordination or senior tranches.

Another Group member cautioned that subordination can exist in complex instruments and arrangements. All relevant facts and circumstances need to be considered before determining that the contractually linked guidance does not apply.

A Group member noted another factor to consider is the right to sue for failure to pay the amounts otherwise due, which can include more than the cash in the entity.

### *Fact Pattern 4*

Entity C holds an investment in shares of Entity D. Holders of these shares can put them back to Entity D and receive a cash payment equal to the net asset value per share of Entity D, which is determined based on the fair value of the net assets of Entity D.

Entity D classifies these shares as equity. The notes to Entity D's financial statements explain that the shares are classified as equity because they met the special conditions for equity classification set out in paragraphs 16A and 16B of IAS 32 *Financial Instruments: Presentation*, which relate to puttable instruments.

### ***Issue 4: How should Entity C classify its investment in Entity D's shares under IFRS 9?***

*View 4A – Classify at fair value through profit or loss (FVTPL) with the option to irrevocably elect to classify at FVOCI.*

Entity D's shares are legal form equity instruments classified as equity in Entity D's financial statements. Therefore, Entity C's investment is an investment in an equity instrument that would be recorded at FVTPL under IFRS 9. However, Entity C could make an irrevocable election under IFRS 9 to classify the investment in Entity D's shares at FVOCI, presuming that this investment is not held for trading by Entity C.

*View 4B – Classify at FVTPL only.*

Paragraph BC5.21 in the Basis for Conclusions of IFRS 9 is relevant to this issue.

“IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading. The term ‘equity instrument’ is defined in IAS 32 *Financial Instruments: Presentation*. The IASB noted that in particular circumstances a puttable instrument (or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation) is classified as equity. However, the IASB noted that such instruments do not meet the definition of an equity instrument.”

The IFRS Interpretations Committee reinforced this guidance in its agenda decision on this topic released in September 2017.

As a result, Entity C would not be able to classify its investment in Entity D’s shares at FVOCI. If Entity C puts the shares to Entity D, Entity D must redeem them for an amount based on the fair value per share of its assets. Entity C would conclude that this settlement amount is not consistent with a normal lending arrangement and causes the instrument to fail the “solely payments of principal and interest” conditions in IFRS 9. As a result, the investment in Entity D’s puttable shares would be recorded at FVTPL.

### *The Group’s Discussion*

Group members observed that the classification exception does not override the conclusion that a puttable equity instrument is a financial liability and is not eligible for the FVOCI election that is available for investments in equity instruments.

Overall, the Group’s discussion of these four fact patterns raises awareness in applying some of the principles related to classification and measurement of financial assets in IFRS 9. No further action was recommended to the AcSB.

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

## **IAS 8 and IAS 12: Change in Tax Rate for Indefinite Life Intangible Assets**

At its [November 29, 2016 meeting](#), the Group discussed the IFRS Interpretations Committee’s agenda decision<sup>2</sup> regarding the expected manner of recovery of an intangible asset with an indefinite useful life for purposes of measuring deferred tax. At that time, the Group discussed how the retrospective adjustment should be accounted for if the agenda decision resulted in a change in the deferred tax rate that is considered a change in accounting policy. The Group considered the issue using a fact pattern in which the entity had not applied the exemptions available under IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

In this meeting’s discussion, the Group considered the same issue, except that in the fact pattern below, the intangible asset arose from a business combination prior to the entity’s adoption of IFRS Standards.

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<sup>2</sup> Published in [November 2016 IFRIC® Update](#)

### *Fact Pattern*

- In 2009, Entity A acquired Entity B via a share purchase arrangement and accounted for the transaction as a business combination in accordance with pre-changeover Canadian GAAP.
- On acquisition, Entity A recognized a brand asset as an indefinite life intangible asset with a corresponding deferred tax liability based upon the recovery of the brand-asset by sale. The excess consideration paid over the assets acquired and liabilities assumed in the acquisition was recognized as goodwill.
- Entity A adopted IFRS Standards on January 1, 2011, with a transition date of January 1, 2010. The entity applied the IFRS 1 exemption not to apply IFRS 3 *Business Combinations* retrospectively to past business combinations. Entity A continued to measure the deferred tax liability on the brand asset based on a tax rate assuming recovery through sale.
- As a result of the IFRS Interpretations Committee's agenda decision, the entity concluded there is a change in tax rate. This change in tax rate is viewed as a change in accounting policy that gives rise to a retrospective adjustment.

***Issue: Should the retrospective adjustment in the fact pattern above be affected by Entity A's application of the IFRS 1 exemption not to apply IFRS 3 retrospectively to past business combinations?***

*View A – Yes, the application of the IFRS 1 exemption prohibits Entity A from recognizing the retrospective adjustment in goodwill.*

The deferred tax liability originated from the recognition of the brand asset that arose from a business combination prior to the entity's adoption of IFRS Standards. Paragraph C4(b) of IFRS 1 requires that a first-time adopter recognize "all its assets and liabilities at the date of transition to IFRSs that were acquired or assumed in past business combinations." This paragraph also requires that a first-time adopter recognize "any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill."

Proponents of this view note that the change in accounting policy should be applied retrospectively to Entity A's transition date of IFRS Standards. The retrospective adjustment should be reflected as an adjustment to opening retained earnings and not to goodwill.

*View B – No, the application of the IFRS 1 exemption does not prohibit Entity A from recognizing the retrospective adjustment in goodwill.*

Proponents of this view note that while it is important to consider the effects of IFRS 1 elections on any retrospective adjustment, the recognition and measurement of deferred tax assets and liabilities acquired in a business combination is based on guidance in IAS 12 *Income Taxes* due to the scope exception in paragraph 24 of IFRS 3.

### *The Group's Discussion*

Group members who expressed a view mainly supported that the application of the IFRS 1 exemption prohibits Entity A from recognizing the retrospective adjustment in goodwill

(View A). There is a distinct accounting difference between an entity that has elected not to restate past business combinations and an entity that has not made such an election because of what is stated in paragraph C4(b) of IFRS 1. Goodwill is a frozen balance because of applying the IFRS 1 exemption and is not subject to change, unless some other transition provision specifies otherwise. One Group member's view is that since there is no scope exception for IAS 12 in IFRS 1, paragraph C4(b) of IFRS 1 would not apply.

The Group's discussion raises awareness about this item, particularly highlighting the broader consideration of how IFRS 1 interacts with subsequent accounting policy changes. 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**

### **IFRS 9: Modifications or Exchanges of Financial Liabilities that do not Result in Derecognition**

After the Group's discussion of this [issue](#) at its May 2017 meeting, the IFRS Interpretations Committee did not finalize the agenda decision but instead referred the issue to the IASB. The IASB concluded that the requirements in IFRS 9 are adequate such that further standard-setting action is not required. To highlight this matter, the IASB decided to include the discussion on the accounting for modification or exchange of financial liabilities in the Basis for Conclusions on IFRS 9 *Financial Instruments* in the amendments to IFRS 9 for "Prepayment Features with Negative Compensation."

### **IAS 12: Interest and Penalties Related to Income Taxes**

After the Group's discussion of this [issue](#) at its May 2017 meeting, the IFRS Interpretations Committee finalized the [agenda decision](#). An important point to note is that the agenda decision explicitly states that entities do not have an accounting policy choice between applying IAS 12 *Income Taxes* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If an entity considers a particular amount payable or receivable for interest and penalties to be income tax, then the entity applies IAS 12 to that amount. The agenda decision also refers to previous discussions that the IFRS Interpretations Committee has had on what is within the scope of IAS 12. Those discussions indicate that IAS 12 applies to taxes that are based on taxable profit, and that the term "taxable profit" implies a notion of a net rather than gross amount. Canadians are encouraged to be aware of the implications of this agenda decision as it may have an effect on practice in Canada.

### **IFRS 5: Abandonment or Sale of a Mineral Property**

At the September 2016 meeting, the Group suggested that the AcSB consider raising awareness on this [issue](#) regarding the meaning of operation and interaction with the requirements in IFRS 8 *Operating Segments*. The AcSB staff reported to the Group that the issue was brought to the attention of CPA Canada's Mining Industry Task Force on IFRS Standards to raise awareness. The Task Force noted that the issue is not sufficiently widespread to pursue further action.

### IFRS 3 and IAS 39: Transaction Price Allocation

At the May 2017 meeting, the AcSB staff reported to the Group that the AcSB submitted this [issue](#) to the IFRS Interpretations Committee in February 2017. The IFRS Interpretations Committee discussed the submission at its June 2017 meeting and noted two possible approaches of accounting for the acquisition of a group of assets. The IFRS Interpretations Committee also indicated it had not obtained evidence that the outcomes of applying the two approaches would have a material effect on the amounts that entities report. Therefore, a [tentative agenda decision](#) was published proposing not to add the issue to its work plan.

The IFRS Interpretations Committee will be discussing responses to its tentative agenda decision, including that of the AcSB, at a future meeting.

### IFRS 16 and IAS 34: Variable Lease Payments

At the May 2017 meeting, the Group recommended that the [issue](#) be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee.

The AcSB agreed with the Group’s observation that there is tension in the requirements between paragraph 38(b) of IFRS 16 and paragraph B7 of IAS 34. AcSB staff is directed to monitor how practice is developing to determine the potential effects this issue could have on entities upon the adoption of IFRS 16. The AcSB will continue to discuss this issue at a future meeting.

## OTHER MATTERS

### Reminders on IASB® Documents for Comment and IFRS 9 Amendments

The IASB has issued three documents for comments from June to September 2017:

<p><a href="#">Property, Plant and Equipment—Proceeds before Intended Use (Proposed amendments to IAS 16)</a></p> <p>The Group has discussed this issue in several meetings given its importance to capital intensive industries like mining (i.e., <a href="#">December 2014</a>, <a href="#">May 2016</a> and <a href="#">November 2016</a>)</p>	<p>Comments were due October 19, 2017</p>
<p><a href="#">Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)</a></p>	<p>Comments due January 15, 2018</p>
<p><a href="#">Definition of Material (Proposed amendments to IAS 1 and IAS 8)</a></p>	<p>Comments due January 15, 2018</p>

Canadians are encouraged to submit their comments to the IASB, and also to the [AcSB’s corresponding Exposure Draft](#) on these topics, by the comment period deadlines (see table above).

The IASB also issued amendments to IFRS 9 on “Prepayment Features with Negative Compensation” in mid-October. These amendments have been incorporated into [Part I of the CPA Canada Handbook – Accounting](#) as of November 1, 2017. The AcSB worked closely with the IASB to ensure its endorsement process in Canada is completed in time for entities who are early adopting the new financial instruments standard.

## Non-authoritative Material – IFRS 9, IFRS 15 and IFRS 16

As of November 1, 2017, the AcSB has completed its phased approach of incorporating the IASB's Basis for Conclusions on IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* into [Part I of the CPA Canada Handbook – Accounting](#). This non-authoritative material is provided to help stakeholders with implementing the new standards.<sup>3</sup>

### Pension and Post-employment Benefit Plans

In September 2017, the Canadian Institute of Actuaries Task Force on Mortality Improvement issued a final [report](#) that provides an analysis of the rate of mortality improvement for the Canadian population. The report also provides the construction of a mortality projection scale for the purpose of reflecting future mortality improvement in Canadian actuarial work. Canadians are encouraged to stay abreast of discussions in this area.

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

## PRIVATE SESSION

In November 2016, the AcSB expanded the Group's mandate to include assisting the Board in influencing the development of IFRS Standards (e.g., providing advice on potential changes to IFRS Standards). The Group's discussion of these matters support the AcSB in undertaking various activities to ensure the Canadian perspectives are considered internationally. Since these discussions do not relate to assisting stakeholders in applying issued IFRS Standards, this portion of the Group's meeting is generally conducted in private (consistent with the AcSB's other advisory committees).

### IASB Documents for Comments

At the October 2017 meeting, the Group provided input to the IASB staff on the Exposure Draft, "[Property, Plant and Equipment—Proceeds before Intended Use \(Proposed Amendments to IAS 16\)](#)." The Group also provided input on the IASB's potential proposal to lower the impracticability threshold for retrospective application of voluntary changes resulting from agenda decisions.

In addition, the Group also discussed the following two documents to assist in the development of the AcSB's response letter:

- IASB Exposure Draft, "[Definition of Material \(Proposed amendments to IAS 1 and IAS 8\)](#)"; and
- IASB Exposure Draft, "[Accounting Policies and Accounting Estimates \(Proposed amendments to IAS 8\)](#)".

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<sup>3</sup> The Illustrative Examples relating to IFRS 9, IFRS 15 and IFRS 16, and the Implementation Guidance relating to IFRS 9, have also been added to Part I of the CPA Canada Handbook – Accounting. Non-authoritative material issued by the IASB accompany, but are not part of, the respective standards.