IFRS Discussion Group

Report on the Public Meeting

September 5, 2013

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

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

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

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

Items Presented and Discussed at the September Meeting

IFRS 3 and IFRS 13: Business Combinations with Consideration Including Shares Subject to Restrictions

IFRS 9 and IAS 39: Flow-Through Shares from the Holder's Perspective

IFRS 11: Application Issues

IFRS 13: Fair Value Measurement Unit of Account

IAS 7: Classification of Interest in the Statement of Cash Flows

IAS 36: Impairment and Reversal Indicators for Commodity-Based Companies

IAS 36: Reversal of Impairment – Part 1: CGU remains unchanged

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Update on Previous Items Discussed by the Group

ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

IFRS 3 and IFRS 13: Business Combinations with Consideration Including Shares Subject to Restrictions

Publicly traded shares are commonly delivered by the acquirer as consideration in the acquisition of a business. In some cases, the shares can be restricted from being traded for a specified period of time subsequent to the acquisition.

When a Canadian public company issues shares in Canada to effect a business combination, in some circumstances, the shares may be subject to a trading restriction under Canadian securities law (i.e., may only be sold to accredited investors or traded pursuant to another securities law exemption). Such a restriction is reflected by a legend on the shares. The restriction period in this case is typically short (for example, four months). However, in some circumstances the shares are restricted by separate agreement between the parties to the business combination and the period of restriction may be more significant depending on the facts and circumstances.

The issue the Group considered was how the requirements in IFRS 13 *Fair Value Measurement* interact with those in IFRS 3 *Business Combinations* when determining the fair value of restricted shares issued as consideration by the acquiring entity in a business combination.

Fact Pattern

- Acquirer delivers shares as consideration in the acquisition of Target (all-share transaction). Acquirer's shares are actively traded in a public market. The shares delivered are restricted from being sold by the vendor of Target.
- Without the restriction, the shares used to purchase Target would be worth $100 using quoted prices.

Scenario 1 – Shares restricted by legend.

- The restriction is for a period of four months subsequent to the acquisition by virtue of the legend to the share certificate.
- The purchase price would be $99 if cash was paid as opposed to an all-share transaction.

Scenario 2 – Shares restricted but the restriction is not a characteristic of the share.

- The shares are restricted based on a separate agreement whereby the shares delivered as consideration to the vendor of Target are held in escrow for a period of two years.
- The purchase price would be $90 if cash was paid as opposed to an all-share transaction.

What is the fair value of the restricted shares issued as consideration by the acquiring entity in each scenario? Does the nature of the restriction affect the fair value determination of the shares when considering the interaction between IFRS 3 and IFRS 13?

The Group's Discussion

For Scenario 1, Group members noted that the restriction is a specific characteristic of the shares because it is created by law. Group members generally agreed that the fair value when considering the requirements in both IFRS 3 and IFRS 13 is $99 given the facts presented. Group members noted that the restriction in Scenario 1 is the kind of circumstance that IFRS 13 contemplates adjusting the observable Level 1 input (i.e., the fair value of a share without the restrictions of $100) because the restriction would be transferred with the share if the share were to be transferred during the restriction period.

For Scenario 2, Group members noted that the shares are restricted by way of a separate agreement rather than by law or statute and, thus, the restriction is not a characteristic of the shares themselves. Group members expressed mixed views on whether the value of the equity instruments issued by the acquirer that should be recorded in share capital of the acquirer is $100 or $90 when considering IFRS 3 and IFRS 13.

- Some Group members argued that regardless of whether the restriction is by law or contract, the fair value of the shares is $90. The aggregate consideration transferred in a business combination should be measured at fair value in accordance with paragraph 37 of IFRS 3. Consistent accounting should result for both scenarios regardless of the nature of the restriction.
- Some Group members argued that the fair value of the shares is $100 because the restriction is created by a separate contract and there is specific guidance in paragraph 45 of IFRS 13, which appears to not permit the inclusion of a restriction on transfer in the determination of fair value of the entity's own liabilities or equity instruments. The principles of IFRS 13 also encourage the use of a price x quantity valuation methodology when a Level 1 input exists. IFRS 13 prevails over IFRS 3 because IFRS 13 is the umbrella standard for applying fair value. As a result, the guidance in paragraphs 39, 45, 69 and 79(c) of IFRS 13 is relevant.

Some Group members expressed surprise that IFRS 13 could create different results for Scenarios 1 and 2. Group members observed that there is tension in the interplay between IFRS 3 and IFRS 13 and, depending on perspective, different views are held (i.e., View A is supported by an IFRS 13 perspective and View B is supported by an IFRS 3 perspective).

Group members noted that the difference arises only in the determination of the fair value of the equity shares issued. The value of aggregate consideration (being the shares and the separate agreement relating to the restriction) under IFRS 3 for the business combination is the same under both views in Scenario 2 and is based on the $90 regardless of whether the restriction is considered separate to the shares.

If the restriction is not a characteristic specific to the shares and IFRS 13 requires the fair value of the shares at $100, a further issue arises regarding where the additional $10 debit (being the difference between the consideration for the acquired assets and the fair value recorded to common share equity) should be recorded in Acquirer's financial statements?

- *View A1 – The difference is recorded as contra equity.*
- *View A2 – The difference is recorded as an expense.*
- *View A3 – The difference is recorded to goodwill.*

Group members debated these three options noting that there are valid arguments against each option. Some Group members think that taking a contra equity approach (View A1) is problematic because this approach gives rise to the same result as if $90 was used on the first issue. Some Group members struggle with a charge to expense (View A2) because the difference doesn't appear to be a cost of an acquisition given that the restriction is on the holder of the shares rather than a cost from the issuer's perspective. Some Group members are troubled by adjusting goodwill (View A3) because this approach gives rise to a day two impairment issue and also implicitly measures the consideration at $100 which is not consistent with the conclusion that the fair value of the consideration is only $90.

Group members noted that any preference for one option over the other two is by default depending on which two options appear to be the least valid. Group members did not express a preference for recording the difference as an expense (View A2) and several Group members commented that recording the difference to goodwill (View A3) is clearly incorrect.

Group members considered whether to recommend to the AcSB that the issue should be referred to the IFRS Interpretations Committee. Group members observed that discussing this issue was considered important because there are so many transactions issued through shares in Canada and IFRS 13 is a new standard.

Group members observed that this issue is currently being discussed globally. Further, when considered at a global level, the analysis becomes more complex because shares issued in other jurisdictions may have different features given there are different securities laws and business practices. Another fact pattern in Canada is when a restriction of three years is imposed in the junior market by the stock exchange rather than securities law.

Group members commented that the differential can be material when the business combination is significant and especially when the restriction period is lengthy. Group members observed that the underlying issue is that IFRS 13 appears to treat restrictions that are not legally part of the shares differently than restrictions that are part of the shares. However, if this interpretation is appropriate, it is unclear what to do with the differential that arises using a price x quantity valuation.

As a result, the Group recommended that the AcSB refer this issue to the IASB or IFRS Interpretations Committee.

IFRS 9 and IAS 39: Flow-Through Shares from the Holder's Perspective

Current Canadian tax legislation permits entities in mining or oil and gas exploration, and entities in certain emerging technologies, to issue flow-through shares to investors to finance qualifying expenditures.

The purchase of the flow-through share gives the investor rights to a common share of the issuer, and a future tax deduction, equal to the cost of the initial investment. The tax deduction may be taken once the issuer renounces the qualifying expenditures.

The investor typically pays a premium for the flow-through share, compared to a non-flow-through common share, because the investor also obtains the benefit of a future tax deduction.

There are two ways for an issuer to renounce the qualifying expenditures to the purchaser:

- General rule: The costs are factually incurred by the corporation and renounced at a later date within a 24-month period.
- Look-back rule: The costs are not incurred as at the renunciation date. The costs are "deemed" to have been incurred on the last day of the calendar year. There is a requirement to incur expenditures by the end of the next calendar year.

If the qualifying expenditures are not made by the timelines required under the tax legislation, tax authorities will deny the purchaser's tax deduction. However, in the flow-through share agreement, the issuer will typically indemnify the purchaser for the loss in tax benefit if the issuer fails to make the required qualifying expenditures.

The original purchaser can sell the underlying common share at any time (subject to any resale restrictions under securities legislation). However, the original purchaser of the flow-through share retains the tax benefit from the renounced expenditures. This tax benefit cannot be sold or transferred to the subsequent purchaser.

IFRSs do not explicitly address the accounting for flow-through shares. The accounting for flow-through shares from an issuer's perspective was discussed by the Group in November 2009 and September 2010. Also, two industry committees, the Oil and Gas Industry Task Force and the Mining Industry Task Force, have published non-authoritative Viewpoints on the accounting from an issuer's perspective.[1] However, limited guidance, if any, is available on the accounting from a holder's perspective.

[1] See Viewpoints: Applying IFRS in the Mining Industry – Flow-Through Shares and Applying IFRS in the Oil and Gas Industry – Flow-Through Shares

Issue 1: When should the flow-through share be split into its component parts of an investment in equity securities of another entity and a tax benefit to the original investor?

View 1A – Upon renunciation by the issuer.

Under this view, the purchase of the flow-through share is in substance seen as the purchase of a single financial asset (investment in flow-through shares) in the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. The right to the tax benefit is recognized separately only upon renunciation by the issuer of the flow-through share.

Subsequent to renunciation, the investment continues to be accounted for in accordance with IAS 39 and the tax benefit is accounted for in accordance with IAS 12.

View 1B – Flow-through shares are split on initial recognition.

Under this view, the purchase of the flow-through shares is in substance seen as the purchase of two assets that have been bundled together, being:

- an investment in another entity (in the scope of IAS 39); and
- a purchase of a right to tax deductions.

On initial recognition of the transaction, these two components are recognized and accounted for separately. There are three sub-views for the measurement of the component parts at initial recognition:

View 1B.1 – The tax benefit asset is assigned a residual.

View 1B.2 – The tax benefit asset is assigned a relative fair value based on the purchase price.

View 1B.3 – Either residual value or relative fair values may be used as an accounting policy choice.

The Group's Discussion

Group members supported View 1B that the flow-through shares should be split into two component parts upon initial recognition observing that this approach creates symmetry with the issuer's accounting. However, Group members expressed mixed views regarding how to separate the transaction into the component parts.

Some Group members supported the residual approach (View 1.B.1) because the relative fair value approach (View 1.B.2) results in the initial recognition of the equity investment not at fair value, which is inconsistent with IAS 39 and would give rise to a day two gain. Also, some Group members did not support the relative fair value approach because of concerns over double counting the tax benefit. Other Group members supported that there is an accounting policy choice (View 1.B.3) noting that it is difficult to preclude either the residual or relative fair value approach because IFRSs do not include any specific guidance.

Issue 2: When are the effects of renunciation recognized?

Under the look-back rule, an issuer may renounce expenditures in one year (for example 20X2). However, investors are eligible to take the deduction in their prior year tax return, which is 20X1 in this example.

If the financial statements are authorized for issuance after the renunciation has occurred, are the effects of the renunciation recognized in the 20X1 or 20X2 financial statements?

View 2A – 20X1 financial statements (the renunciation is an adjusting event).

View 2B – 20X2 financial statements (the renunciation is a non-adjusting event).

The Group's Discussion

Group members commented that similar to an issuer's perspective, from the holder's perspective the issue becomes more complex when considering the look back provisions. Group members noted that the difference between the two views is whether to reflect the tax benefit as current or deferred.

Some Group members supported that the renunciation is an adjusting event (View 2A) because the shares were acquired prior to the end of the reporting period and contain the rights to the tax benefit. Some Group members supported that the renunciation is a non-adjusting event (View 2B) because at the end of the reporting period there could not be certainty over whether the renunciation would occur and the renunciation is a discrete event occurring after the reporting period.

Group members observed that a key fact from the issuer's perspective was that the renunciation is generally perfunctory and if it does not occur a penalty is imposed. However, Group members commented that the distinction between the issuer and holder perspectives is that the renunciation is controlled by the issuer. At the end of the reporting period, the holder does not know whether the underlying nature of the asset is a current tax benefit or a right to be made whole by the issuer. From the holder's perspective, the renunciation is a discrete event after the end of the reporting period outside of the holder's control.

Group members discussed whether to recommend the AcSB take any further action regarding this issue. Group members were reluctant to recommend referring this issue to the IFRS Interpretations Committee because it is unique to Canada and arises in a couple of industries only. The Group decided not to recommend further action to the AcSB regarding this issue.

An observer on the Oil and Gas Industry Task Force that published the non-authoritative Viewpoint on the accounting from an issuer's perspective, offered to raise the issue from a holder's perspective with that committee.

IFRS 11: Application Issues

Issues have been raised regarding the classification of a joint arrangement as a joint venture or a joint operation and the accounting for joint operations under IFRS 11 *Joint Arrangements*.

Group members were asked to determine which of the following six issues are most significant in practice in Canada.

Issue 1: Should the assessment of "other facts and circumstances" be based only on enforceable contractual terms?

- ***Issue 1.1: What if the entity, based on its stage of development, currently is not producing output and has not yet documented a contractual obligation for the parties to take the output, when and if such output should arise?***

View 1A – Yes, the assessment is based only on current enforceable contractual terms.

View 1B – No, economic compulsion is sufficient.

View 1C – No, intention alone is sufficient.

Issue 2: When the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?

View 2A – No, the arrangement is a joint operation.

View 2B – Yes, the arrangement is not a joint operation.

View 2C – It depends, this fact alone should not be considered in isolation.

Issue 3: When assessing "other facts and circumstances", does financing from a third party prevent an arrangement from being classified as a joint operation?

View 3A – No, not if it is guaranteed by the parties.

View 3B – No, not if it is during the pre-production, construction phase.

View 3C – No, ultimately the parties to the arrangement need to fund any external debt.

View 3D – Yes, third party debt prevents classification as a joint operation.

View 3E – It depends, this fact alone should not be considered in isolation.

Issue 4: When assessing "other facts and circumstances", should the assessment be made at the level of the parties as a group or by each party in isolation?

View 4A – A single assessment should be performed at the level of the joint arrangement.

View 4B – Separate assessments should be performed by each party to the joint arrangement.

Issue 5: How should the parties to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the arrangement differs from the parties' ownership interest in the arrangement?

View 5A – Based on the share of output.

View 5B – Based on ownership interest.

Issue 6: Does a party with joint control classify the arrangement based on viewing all phases of the arrangement at the inception or only the current phase?

- ***Issue 6.1: When assessing "other facts and circumstances", how should arrangements that are in the pre-production or pre-construction phase or have sequential activities be assessed?***

View 6A – Current phase only.

View 6B – All phases.

The Group's Discussion

AcSB staff conducted an informal survey of the observers and Group members at the meeting to find out which issues were considered most significant in practice in Canada. Issues 1, 5 and 6 were identified as the most significant and the Group discussed why. Although the Group did not discuss Issues 2, 3 and 4, some observers and Group members noted that those issues are encountered in practice in Canada as well.

Issue 1: Other facts and circumstances based only on enforceable contractual terms

Group members explained that this issue needs to be addressed because it is not clear whether entities should look at facts and circumstances beyond the legal terms.

Group members noted that the three views appear to be relatively complete:

View 1A – Yes, the assessment is based only on current enforceable contractual terms.

The assessment of the parties' rights and obligations when considering other facts and circumstances (as described in paragraphs B29-B32 of IFRS 11) is based on enforceable terms. By definition, rights and obligations must arise from contractual and/or enforceable terms. A right or an obligation that is not enforceable is not a right or an obligation.

View 1B – No, economic compulsion is sufficient.

Economic compulsion on the joint arrangement to sell to the parties and on the parties to purchase the output from the arrangement (without the contractual and legal requirement to do so) is sufficient. Some arrangements are designed so that, realistically, the joint arrangement can only sell to the parties, and the parties are economically compelled to purchase the output. The notion of economic compulsion is consistent with the reference to "design" and "in substance" in paragraphs B31-B32 of IFRS 11.

View 1C – No, intention alone is sufficient.

The other facts and circumstances test is an in-substance test and, therefore, intention evidenced through design is sufficient to meet the requirement on its own. Paragraphs B31-B32 of IFRS 11 focuses on the design of the arrangement. No mention is made of the need for a contract or economic compulsion.

Issue 5: Share of output differs from the ownership interest

Group members noted that the issue is faced by entities in Canada. Group members observed that care should be taken in addressing this issue because the appropriate view might depend on the facts and circumstances of the joint arrangement:

View 5A – Based on the share of output.

The parties should account for their share of assets and liabilities based on the share of output purchased by the parties from the arrangement if this determines the rights and obligations that the parties have in respect of the assets and liabilities relating to the arrangement.

View 5B – Based on ownership interest.

The parties should account for their share of assets and liabilities based on their ownership interest in the arrangement. IFRS 11 does not specify how to account for the imbalance between the amount invested by each party and the amounts recognized by each party for the share of assets and share of liabilities, both at inception of the joint operation and on an ongoing basis.

Issue 6: Arrangements in the pre-production or pre-construction phase

Group members noted that some joint arrangements operate in phases, such as those in the mining/extractive, construction, and real-estate industries.

Group members observed that this issue is common in Canada, particularly when classifying an arrangement prior to any output being generated. Group members noted that the question focuses on whether all phases, or the current phase, should be considered when classifying a joint arrangement, and the answer to this question may depend on the facts and circumstances of the joint arrangement.

Group members noted that a better question for the IFRS Interpretations Committee to consider is whether IFRS 11 requires, or should require, a continuous assessment model similar to the one in IFRS 10 *Consolidated Financial Statements.* Exploring the answer to this question would provide a principle that could be applied across different arrangements regardless of the phase.

Group members observed that IFRS 12 *Disclosure of Interests in Other Entities* specifically requires disclosures in this area.

The Group decided that no further action was required at this time because all six issues are currently being considered by the IFRS Interpretations Committee. AcSB Staff will continue to monitor that Committee's work on these issues.

IFRS 13: Fair Value Measurement Unit of Account

IFRS 13 *Fair Value Measurement* defines fair value, establishes a framework for measuring fair value and a fair value hierarchy based on the source of the inputs used to estimate fair value, as well as providing disclosure requirements. IFRS 13 does not establish new requirements for when fair value is to be used. To determine when fair value is to be used, one must look to individual standards such as IAS 39 *Financial Instruments: Recognition and Measurement* when accounting for financial instruments and IAS 36 *Impairment of Assets* when measuring a cash-generating unit for impairment.

In applying the guidance in paragraph 14 of IFRS 13, the unit of the account of the item to be valued must be determined first:

> "Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its unit of account. The unit of account for the asset or liability shall be determined in accordance with the IFRS that requires or permits the fair value measurement, except as provided in this IFRS."

Sometimes, the unit of account is self-evident. However, determining the appropriate unit of account may be more difficult when two standards appear to overlap because IFRSs on those topics do not provide further guidance. For example, what is the unit of account when the investment is held in the form of shares quoted in an active market but is sufficiently large to require accounting as an associate, a joint venture or a subsidiary?

An issue could arise in many situations including the following:

- an investment in a subsidiary, joint venture or associate accounted for in accordance with IFRS 9 or IAS 39 in separate financial statements;
- an investment in a joint venture or associate accounted for in accordance with IFRS 9 or IAS 39 by a venture capital or similar organization;
- an investment in a subsidiary, joint venture or associate measured at fair value in accordance with IFRS 9 or IAS 39 by an investment entity;
- shares in a subsidiary, joint venture or associate distributed to owners.
- a previously held equity interest in an acquiree in accounting for a business combination achieved in stages;
- a retained interest following a loss of control, joint control or significant influence; and
- a cash-generating unit that consists of a publicly listed entity.

The Group considered how to determine the unit of account when measuring the fair value of an associate, joint venture or subsidiary (herein referred to as "investment") when the shares of the

investee are quoted in an active market. Is the unit of account the entire investment (View A) or the individual share (View B)? What should be given primacy when measuring the investment at fair value, the nature of the investment along with the unit of account or price multiplied by quantity (referred to as "P x Q")?

The Group's Discussion

Group members observed that the IASB has a current implementation project to consider these questions. Group members highlighted that this project only relates to investments that have a quoted price in an active market and will not affect investments held in private entities.

Group members noted that the IASB tentatively decided that the unit of account is the investment as a whole (View A). However, the IASB also tentatively decided that when the shares underlying the investment being measured at fair value are publicly traded in an active market, the quoted price multiplied by the quantity of shares held should be given primacy over the unit of account. Further project information is available on the IASB's Fair Value Measurement: Unit of Account project page.

Group members noted that understanding the basis for the IASB's tentative decision that the quoted price multiplied by the quantity of shares overrides the unit of account is a struggle. Group members observed that there will be important implications if ultimately the IASB issues amendments to clarify IFRSs for this tentative decision. For example, an entity would not be permitted to recognize any premium that is reflected in the size of the holding, such as a control premium.

Group members commented that it is important to recognize that the IASB's decision is tentative and passed with a very narrow margin with only eight IASB members in agreement. As a result, the tentative decision may not stand in future deliberations.

Group members observed that the IASB's project suggests that there is currently no clear answer and alternative views could continue until the IASB issues amendments. In the intervening period, it is difficult to ignore the IASB's tentative decision, which puts more pressure on supporting a valuation premise that includes a control premium. Group members encouraged preparers to continue to apply a lot of rigour when supporting fair values greater than the quoted price multiplied by the quantity of shares.

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

IAS 7: Classification of Interest in the Statement of Cash Flows

IAS 7 *Statement of Cash Flows* provides an accounting policy choice regarding the classification of cash flows from interest received and paid as operating, investing or financing activities. The classification should be consistent from period to period.

Group members considered whether the presentation alternatives in IAS 7 are affected or limited by the presentation of interest income or interest expense as a component of an alternative GAAP measure such as "income from operations" in the statement of comprehensive income.[2]

Paragraph 86 of IAS 1 *Presentation of Financial Statements* states, in part:

> "An entity includes additional line items in the statement(s) presenting profit or loss and other comprehensive income and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense."

The Canadian Securities Administrators' Staff Notice 52-306 (revised February 2012), "Non-GAAP Financial Measures and Additional GAAP Measures," provides additional guidance around the use of additional GAAP measures. This notice includes six general practices to follow when presenting additional GAAP measures, and also provides some specific guidance relating to measures such as "results from operating activities".

Paragraph 6 of IAS 7 includes the following definitions:

> *"Operating activities* are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
> *Investing activities* are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
> *Financing activities* are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity."

Further, paragraph 33 of IAS 7 states:

> "Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments."

The Group considered whether the inclusion or exclusion of interest income and interest expense in an alternative GAAP measure such as "income from operations" limits the presentation alternatives for interest paid and received in the statement of cash flows.

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[2] For ease of reference, "statement of comprehensive income" also refers to other titles that could be used such as "statement of profit or loss and other comprehensive income" or the "statement of profit or loss" (when an entity presents a separate statement of comprehensive income as explained under paragraph 10A of IAS 1).

View A – Yes, the presentation should be consistent.

Under this view, the inclusion or exclusion of interest paid and received in operating activities in the statement of cash flows should be consistent with how interest income and expense is presented when an alternative GAAP measure such as "income from operations" is used in the statement of comprehensive income. If interest income and expense is not included in the "income from operations" measure, interest paid or received should not be presented as cash flows from operating activities but rather should be presented as either financing or investing activities.

View B – No, the presentation is not affected because IAS 7 provides a free choice.

Under this view, the inclusion or exclusion of interest income and expense from an alternative GAAP measure such as "income from operations" does not affect the free choice provided in IAS 7 about where interest paid and received should be presented in the statement of cash flows. The basis for this free choice is that interest income and interest expense often meets more than one of the definitions of operating activities, investing activities and financing activities in IAS 7.

The Group's Discussion

The majority of Group members supported View B, noting that IAS 7 provides a free choice. The definition of operating activities in IAS 7 is specific to IAS 7, and does not cross over or relate to how operating activities may be defined or presented under IAS 1 or other standards.

Some Group members wondered what message is communicated to investors, from a big picture perspective, when there is an inconsistent presentation. Further, some struggle with the use of the same terminology but with different meanings within the same set of financial statements.

Several Group members noted that the purpose of the information being communicated in the cash flow statement is fundamentally different from the information being communicated in the statement of comprehensive income. The definition of operating activities in IAS 7 includes "other activities that are not investing or financing activities" and this definition may be inconsistent with how management views operations. Group members noted that the statement of comprehensive income should reflect management's view of income from operations because this presentation provides relevant information to investors. Group members observed that there are other similar presentation inconsistencies between the cash flow statement and the statement of comprehensive income, such as income taxes.

Group members noted that there have been many questions raised to the IFRS Interpretations Committee about the application of IAS 7 and there are many concerns over the IAS 7 terminology.

The Group decided not to recommend further action to the AcSB regarding this issue. Group members observed that the IASB has launched a medium-term project on IAS 1, IAS 7 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, thus providing opportunities in the future for input.

IAS 36: Impairment and Reversal Indicators for Commodity-Based Companies

IAS 36 *Impairment of Assets* indicates that an entity shall assess at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased. Examples of external information that could indicate an impairment reversal include a "significant" increase in market value of the assets or "significant changes with a favourable effect on the entity" such as favourable changes in the "market environment".

The issues for consideration include:

- the application of significance thresholds to indicators of reversal of impairment;
- the unit of account for impairment reversals (for example, whether costs for a written off conventional well should be reinstated if reversal is due to new unconventional extraction techniques); and
- how improvements in pricing occurring after the reporting period but prior to the release of the financial statements should be considered in assessing impairment indicators.

Issue 1: Significance Thresholds for Indicators of Reversal of Impairment

Subsequent to an impairment loss being recognized for an asset, all other things being equal, an increase in commodity prices could lead to a reversal of the previous impairment loss.

Example

- An asset with a carrying value of $100 million was written down to $75 million based on commodity price declines of approximately 25 per cent.
- In assessing impairment, the company's policy was to use a 10 per cent decline in forward commodity prices.
- In the reporting period following the write down, the forward prices improve by two per cent.

As the increase in forward prices would lead to an increase in the fair value of the asset, should a portion of the impairment loss automatically be reversed? Should significance thresholds be applied to indicators of reversal of impairment?

The Group's Discussion

Group members observed that the example was meant to clarify the requirements by narrowly focusing on the price changes in the commodity and a simplified fact pattern when all other factors remain the same. In real life, this factor would not be considered in isolation when making these judgments.

Group members noted that the impairment model is not a mark-to-market model and simply having an increase in commodity prices should not necessarily drive a reversal of impairment. Instead, the impairment model includes the concept of significance and requires consideration of a longer-term horizon. Group members observed that a degree of symmetry is desirable between the thresholds for identifying impairments and reversals. Group members noted that there are no

bright lines when assessing whether a particular price decline or increase is "significant" to an entity because this judgment depends on the nature of the asset being considered and the specific facts and circumstances.

Group members explained that applying a significance threshold is necessary to identify when "normal volatility" is being experienced rather than an indicator of impairment or reversal. Further, the appropriate threshold will be based on how volatile the commodity is. Although these threshold amounts are relevant indicators, other facts and circumstances must then be considered.

Group members observed disclosures are critical in this area to ensure investors are informed of the thought process and significant judgments. Further, disclosures about accounting policies for these significance thresholds are helpful to investors.

Group members observed that IAS 36 requires entities at the end of each reporting period to assess whether impairment indicators and reversal indicators exist. The requirement to reverse impairments is not an accounting policy choice but a requirement that should be viewed with the same level of rigour as impairments and with a degree of consistency.

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

Issue 2: Unit of Account for Impairment Reversals

Group members deferred discussion of this issue to the next agenda item "IAS 36: Reversal of Impairment – Part 2 Assets Are Added to the CGU."

Issue 3: Subsequent Improvement in Pricing

Subsequent to a reporting period, but prior to the financial statements being released, an improvement in commodity prices may occur that would be below an entity's threshold for significance of price changes for impairment testing.

Should this subsequent event be taken into account when assessing indicators of impairment?

View 3A – Yes, the subsequent event should be taken into account.

Whether an indicator of impairment exists is a management estimate. Improvement in pricing after the end of the reporting period but prior to the financial statements being released indicates that:

- the decline in pricing was a temporary phenomenon; and
- a fundamental issue with the recoverability of the property's carrying amount does not exist.

View 3B – No, the subsequent event should not be taken into account.

The objective of an impairment assessment is to determine the recoverability of a property at the end of the reporting period. Subsequent improvements in the pricing of a commodity are indicative of conditions that arose after the reporting period and should not be factored into the

impairment indicator assessment. Such price changes should be considered "non-adjusting" subsequent events under IAS 10 *Events after the Reporting Period*.

The Group's Discussion

Group members observed that the scope of this discussion is limited to the assessment of indicators of impairment and does not relate to the measurement of impairment losses.

Group members noted that View B applies when a new discrete event occurs after the reporting date that drives the changes in commodity prices. However, Group members observed that considering whether subsequent price changes provide additional information about facts that existed at the reporting date is more challenging and requires judgment.

Many Group members expressed support for View B, some noting that viewing such an event as non-adjusting is a good starting point. However, Group members noted that different circumstances might be identified that could change that view and it is not possible to conclude View B will always be the case. As a result, Group members observed that View C, that it depends on the specific facts and circumstances, may be appropriate.

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

IAS 36: Reversal of Impairment

IAS 36 *Impairment of Assets* requires entities to assess at each reporting date whether there is any indication that a previously recognized impairment loss no longer exists or has decreased. If there is any such indication, the entity should estimate the recoverable amount. This applies both to individual assets other than goodwill and to cash-generating units (referred to as "CGUs"). Paragraph 111 of IAS 36 lists the external and internal indicators that an impairment loss recognized in prior periods may no longer exist or may have decreased.

IAS 36 requires that, if possible, impairment should be assessed for individual assets. If the recoverable amount cannot be determined for the individual asset, the entity determines the carrying amount of the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Part 1: CGU remains unchanged.

The issue for consideration is whether a reversal of impairment must be specific to the original event that gave rise to the impairment, when the composition of the cash-generating unit does not change subsequent to the impairment loss.

Fact Pattern

- An entity has identified one cash-generating unit that consists of various assets. These assets are integral to the operations such that independent cash inflows cannot be determined for the assets within the cash-generating unit.

- Both the costs and revenues of the cash-generating unit are dependent on market prices for commodities. The revenues are sensitive to the market prices for Commodity A as well as to foreign exchange rates. The input costs/expenses are sensitive to the market prices for Commodity B.
- During 20X0, the current and long-term market prices for Commodity B increase due to an unexpected reduction in supply, which reduces the forecasted future cash flows and profitability of the cash-generating unit. There hasn't been a similar increase in the current and/or long-term prices of Commodity A to offset the increase in input costs. Foreign exchange rates are also unchanged.
- At the end of the 20X0 reporting period, due to the adverse change in the business triggered by the increase in the price of Commodity B, the entity identified an indicator of impairment. The entity calculated the recoverable amount of its cash-generating unit and recognized an impairment loss at the end of 20X0.
- From 20X0 to 20X2, the composition of the assets included in the cash-generating unit remains the same such that no new assets were added to the cash-generating unit.

Scenario 1 – The indicator of reversal relates to the same event or condition that gave rise to the original impairment loss.

- During 20X2, the current and long-term market price for Commodity B decreased to the prior historical levels before the impairment was recorded in 20X0. This decrease is due to the completion of several large projects which have significantly reduced the global supply issues. As a result, the input costs/expenses have decreased along with a corresponding favourable increase in cash flows and profitability.

Scenario 2 – The indicator of reversal does not relate to the same event or condition that gave rise to the original impairment loss.

- During 20X2, the current and long-term market price for Commodity B remains at the same level as 20X0 when the impairment was recognized. However, the current and long-term market price for Commodity A has increased as a result of higher global demand due to changing economic conditions. As a result, revenues have increased along with a corresponding favourable increase in cash flows and profitability.

Is an indicator of reversal present under each scenario?

View A – An indicator of reversal must relate to the same event or condition that gave rise to the impairment loss.

Under this view, an indicator of reversal is present in Scenario 1 only.

View B – An indicator of reversal does not need to relate to the same event or condition that gave rise to the impairment loss.

Under this view, an indicator of reversal is present in Scenario 1 and 2.

The Group's Discussion
Group members supported View B, noting that any indicator of reversal listed in paragraph 111 of IAS 36 would meet the criteria for assessing whether an impairment loss should be reversed. Further, paragraph 114 of IAS 36 is clear that the assessment is based on any factor that would positively affect the asset's recoverable amount, rather than being based on whether the original impairment indicator has changed.

Group members noted that it is difficult to identify a single factor that, in isolation, has caused an impairment loss because often many factors contribute to the decline in the estimate of recoverable amount. Similarly, it is often many factors that trigger a reversal of impairment, and which factor gave rise to the original impairment loss is not relevant.

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

Part 2: Assets are added to the CGU

The issue for consideration is whether an indicator of reversal can arise from an improvement in the estimate of recoverable amount due to the addition of assets to the cash-generating unit.

Fact Pattern 1

- An entity has a cash-generating unit consisting of various operating assets that produce outputs (for example, a commodity or other physical product). Each of the assets is integral to the operation such that independent cash inflows cannot be determined for the individual assets within the cash-generating unit.
- During 20X0, the level of production generated by the assets declined from prior periods due to various issues including the use of older technology. At the end of 20X0, the entity identified an indicator of impairment, calculated the recoverable amount of the cash-generating unit and recognized an impairment loss. No goodwill had been allocated to the cash-generating unit so the impairment loss was allocated pro rata to the non-financial assets of the cash-generating unit on the basis of the carrying amount of each asset in the unit consistent with paragraph 104 of IAS 36.
- During 20X2, the entity acquired new assets through an asset acquisition. The entity appropriately added the new assets to the existing cash-generating unit because they were integrated into the existing operations. Similar to the existing assets, these new assets are integral to the operations such that independent cash inflows cannot be determined for the individual assets within the cash-generating unit.
- At the end of 20X2, the addition of the acquired assets has resulted in an increase in the recoverable amount of the cash-generating unit.

Is an indicator of reversal present under this fact pattern?

View A – An indicator of reversal must relate to the same composition of assets in the cash-generating unit when the impairment loss was recognized and should not be triggered by the addition of new assets to the cash-generating unit.

Under this view, the prior impairment loss would not be reversed.

View B – An indicator of reversal does not need to relate to the same event or condition that gave rise to the impairment loss.

Under this view, the reversal of the impairment loss should be recognized and appropriate disclosures made.

The Group's Discussion

Group members supported View B, noting that the unit of account for assessing impairment and impairment reversals is the cash-generating unit in its entirety and not the individual assets in the cash-generating unit. Group members observed that View A would likely not be operational and is counter to the principle embedded in IAS 36 that the cash-generating unit is the lowest level at which there are identifiable cash inflows.

Group members observed that this is an area of judgment and the composition of cash-generating units must be stress tested. In all circumstances, but especially when considering impairments or reversals of impairments, it is important to ensure that the cash-generating units are appropriate in reflecting how the business is being managed and that the process for identifying cash-generating units is challenged. When there are any changes in the composition of the cash-generating units, management and auditors must remain skeptical and consider whether there is bias in how the cash-generating unit has been changed.

Group members observed that there is some reluctance to reverse impairments noting that part of this stickiness is due to a fear that the reversal suggests that the impairment may have been an error, especially if a reversal occurs relatively soon after the loss. Also, there may be a reluctance to reverse a previous impairment loss because this entry could potentially lead to a need to assess impairment again in the future. Regardless of these considerations, Group members observed that IAS 36 requires an entity to assess whether there are reversal indicators and, if there are, recognize any improvement in the recoverable amount subject to the requirements in paragraph 117 of IAS 36:

> "The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years".

Fact Pattern 2

- An oil company has drilled 30 conventional oil wells.
- In 2009, there was a steeper than anticipated decline in reserves and the company recognized an impairment loss for the wells, which are now carried at a nominal value.

- The company's previous carrying amount was primarily the cost of the conventional wells rather than acquisition costs for the oil lease rights.
- In 2013, a new unconventional extraction technique was developed that can be applied to obtain reserves that were previously unobtainable from conventional wells. The new technique requires that the oil company drill a new type of well (i.e., the conventional wells are not being used). The availability of the new extraction technique has caused the fair value of the property to increase substantially and new probable reserves to be attributed to it.
- The oil company recognizes depreciation of its oil and gas properties based on proven and probable reserves.

Should the oil company recognize a reversal of impairment?

The Group's Discussion
Group members observed that recognizing a reversal of the previous impairment loss is inappropriate in this fact pattern because the oil wells should have been derecognized or fully depreciated.

Group members noted that a significant difference between the two fact patterns is that the assets in this fact pattern are no longer being used and are sitting idle. Group members were very troubled with the concept of recognizing a reversal because the oil wells should have been derecognized in accordance with the requirements in IAS 16 *Property, Plant and Equipment* leaving no basis for reversing any impairment. Group members observed that reversing the impairment losses in this fact pattern would be akin to setting up internally generated goodwill.

The Group did not recommend any further action be taken regarding these issues.

IAS 39: Measurement of a Unit Comprised of Common Shares and Warrants

When a financial asset or financial liability is recognized initially, paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement* requires that "an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability."

Paragraph 43A of IAS 39 specifies that "if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG76." Paragraph AG76 of IAS 39 states:

> "The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 43A, the entity shall account for that instrument at that date as follows:

(a) at the measurement required by paragraph 43 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 43, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability."

The issue considered by the Group was what the initial and subsequent measurement requirements under IAS 39 are when the fair value of a financial instrument at initial recognition differs from the transaction price (i.e., the fair value of the consideration given or received).

Fact Pattern

Scenario 1

- On October 10, 2013, Entity A participated in a non-brokered private placement of Entity B units. Entity A and Entity B are not related parties and no separate goods or services are provided between the entities.
- Entity A acquired 7 million units of Entity B, a publicly listed entity, at a price of $0.20 per unit, for a total investment of $1.4 million. Each unit consisted of one common share and one non-transferable share purchase warrant.
- Each non-transferable share purchase warrant entitles Entity A to purchase one additional common share of Entity B at a price of $0.30 per share for a period of two years from the date of issue.
- The closing quoted bid price of Entity B's shares at October 10, 2013 is $0.22 per share or $1.54 million. The value of the warrants determined using a Black-Scholes valuation model at initial recognition is $0.75 million.
- During the period ended December 31, 2013 the common shares of Entity B increased in value to $0.25 per share (total $1.75 million). The value of the warrants using a Black-Scholes valuation model increased to $1 million.
- The entity classifies both the shares and the warrants as fair value through profit or loss.

Scenario 2

- Entity C issues a convertible note with a face value of $1 million which has a maturity of three years from its date of issue. The note pays a 10 per cent annual coupon and, on maturity at the end of three years, the holder has an option either to receive a cash repayment of $1 million or to convert the note into Entity B's shares.
- The convertible note is denominated in a currency other than the functional currency of the entity (i.e., violates the "fixed for fixed" criterion).

- Entity C issued the convertible note to unrelated third parties and the convertible note is not traded on a public market. The entity elects to use the IAS 39 "fair value option" to value the instrument in its entirety at fair value through profit or loss.
- At the date of initial recognition the fair value of the entire instrument is determined to be $1.1 million. At the end of the reporting period, the fair value of the entire instrument has increased to $1.25 million.

The issue the Group considered was what the initial and subsequent measurement requirements of IAS 39 are when the fair value of a financial instrument at initial recognition differs from the transaction price (i.e., the fair value of the consideration given or received). Specifically, does paragraph AG76 of IAS 39 apply in these scenarios from both an issuer and investor perspective?

The Group's Discussion

Group members observed that additional factors must be considered before concluding whether paragraph AG 76 of IAS 39 applies in both scenarios.

Any time there is a combination of instruments, and an initial conclusion is reached that the sum of the fair value of the parts does not equal the transaction price, further thought is necessary. Group members noted that the first step is often to examine whether the right inputs have been used in the valuation model by:

- assessing whether the assumptions, such as volatility, are appropriate;
- re-calibrating the valuation model using different inputs to determine if the difference is reduced or eliminated; and
- calibrating the valuation model so that the aggregate transaction price is equal to fair value solving for the unobservable input.

If a difference still exists, Group members observed that it is necessary to question and investigate whether:

- the relationship between the parties is truly arm's length; and
- there really is a standalone transaction, asking:
  - Are there any unidentified benefits or services?
  - Are there any other related contracts?

Group members noted that the answers to these questions may bring in other elements within the scope of IFRS 2 *Share-Based Payment* that would explain the fair value differential.

Group members observed that there is a presumption that the transaction price is at fair value, so it is important to be comfortable with the conclusion that the fair value does not equal the transaction price. Group members noted that if these scenarios involve standalone transactions with an arm's length party for which the model calibrations are appropriate, paragraph AG 76 of IAS 39 would appear to apply. This paragraph includes explicit guidance about how to account for the fair value difference, depending on whether the inputs are observable.

Although the Group's discussion was mainly from a holder's perspective, Group members observed that an issuer is not exempt from the complexity. The Group's discussion is relevant to the issuer because a similar assessment would need to be performed, especially if the instrument is a derivative. Group members observed that it is important for the issuer to truly understand whether the components are both equity, both debt, or a combination of equity and debt because this distinction matters.

Overall, Group members noted that these scenarios are complex and valuation support may be needed. Also, it is important to remember that IFRS 13 *Fair Value Measurement* needs to be considered.

The Group decided not to recommend further action to the AcSB regarding this issue.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

Uncertain Income Tax Positions Acquired in a Business Combination

At the April 2012 meeting, the Group discussed whether an uncertain income tax position that is acquired through a business combination is subject to the recognition and measurement exception in IFRS 3 *Business Combinations* relating to income taxes.

At is July 2013 meeting, the AcSB decided to raise this issue during the IASB's post-implementation review of IFRS 3.