

# IFRS Discussion Group

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## Report on the Public Meeting

December 9, 2014

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

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

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

(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 December 9, 2014 Meeting

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[IFRS 13 and IAS 39: Fair Value Measurement of Government Loans](#)

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## Update on Previous Items Discussed by the Group

[IFRS 11: Joint Arrangements](#)

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## Other Matters

Rate-regulated Activities

IFRS 15: Revenue from Contracts with Customers

IAS 19: Longevity Swaps, Annuity Buy-in and Buy-out and Discount Rate

IAS 16: Accounting for Proceeds and Costs of Testing on Property, Plant and Equipment

## ITEMS PRESENTED AND DISCUSSED AT THE DECEMBER MEETING

### Non-authoritative Guidance

A publicly accountable entity is required to follow International Financial Reporting Standards (IFRSs) in determining its accounting policies for transactions, other events or conditions addressed by those standards<sup>1</sup>.

In paragraph 9 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, it states:

“IFRSs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of IFRSs. Guidance that is an integral part of the IFRSs is mandatory. Guidance that is not an integral part of the IFRSs does not contain requirements for financial statements.”

Guidance that is an integral part of an IFRS (for example, Application Guidance) is mandatory, whereas guidance that is not an integral part of an IFRS (for example, Implementation Guidance, Illustrative Examples and the Basis for Conclusions) are not mandatory.

Paragraphs 10-12 of IAS 8 prescribe an approach to be followed when IFRSs are silent on the accounting for a particular event or transaction. For the purposes of this discussion, this prescribed approach is referred to as the “GAAP hierarchy.”

Paragraph 12 of IAS 8 states:

“In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.”

Management will sometimes encounter transactions or events for which explicit guidance does not exist in IFRSs and will often look to sources of non-authoritative guidance within the GAAP hierarchy, which could be seen to fall within the scope of “other accounting literature.” These forms of non-authoritative guidance might include IFRS Interpretations Committee agenda decisions, staff agenda papers

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<sup>1</sup> IFRSs are Standards and Interpretations issued by the International Accounting Standards Board (IASB) and comprise of the International Financial Reporting Standards, International Accounting Standards, IFRIC Interpretations and SIC Interpretations.

prepared for the IASB or IFRS Interpretations Committee and educational materials produced by the IFRS Foundation.

In some cases, the IFRS Interpretations Committee may decide not to add an issue to its agenda for reasons such as the matter is already the subject of a proposed standard (or a proposed amendment to an existing standard), the subject is so complex that the IFRS Interpretations Committee cannot address the matter within a reasonable period of time, or existing IFRSs are sufficiently clear such that little to no diversity is expected. If the IFRS Interpretations Committee decides not to add an issue to its agenda, it publishes a tentative rejection notice with a comment period of normally not less than 60 days.

The IASB website states:

“Rejection notices do not have the authority of Standards and they will therefore not provide mandatory requirements but they should be seen as helpful, informative and persuasive. The IASB is not asked to ratify rejection notices.”

When the IFRS Interpretations Committee staff reviewed the status of rejection notices in [February 2012](#), it observed that the rejection notices fall within the class of considerations referred to as “other accounting literature” that management may consider when developing or applying an accounting policy in the absence of an IFRS that applies to the transaction or event.

For other materials, such as IASB or IFRS Interpretations Committee staff agenda papers, they set out the issue or question being considered but are not meant to be conclusive as they are just one step in the IASB’s due process. The IFRS Foundation sometimes produces educational materials relating to IFRSs but they do not form part of IFRSs because such materials are non-authoritative and have not been approved by the IASB.

***Issue 1: How should Canadian preparers consider the non-authoritative guidance described above when preparing their financial statements?***

*View 1A – Non-authoritative guidance should be followed.*

Under this view, it is considered that non-authoritative guidance from the IASB (or any of the bodies associated with it) should be followed even though it is not mandatory and does not form part of IFRSs.

*View 1B – Non-authoritative guidance is not required to be followed.*

Under this view, it is considered that non-authoritative guidance is not mandatory as it has not been approved by the IASB and does not form part of IFRSs. Therefore, the non-authoritative guidance should not be required to be followed because a preparer is required to prepare their financial statements “in accordance with IFRSs, as issued by the IASB.”

To the extent that an entity has a transaction or event for which guidance does not exist in the body of IFRSs, a preparer would follow the GAAP hierarchy and determine whether there are any requirements in IFRSs dealing with similar or related issues based on guidance in IAS 8. An entity is not bound to follow the non-authoritative guidance and can develop an accounting policy based on its own research and reference to the existing words in the standards, including the GAAP hierarchy. In situations when

those words allow for more than one interpretation, an entity can apply the interpretation that produces relevant and reliable information about the transaction in the financial statements.

#### *View 1C – It depends*

Under this view, whether non-authoritative guidance should be followed depends on the type of non-authoritative guidance and the facts and circumstances of the situation. If the rejection notice provides clear guidance on how to apply a standard in a given situation, it could be supported that the guidance would be followed when an entity is faced with the same situation. However, professional judgment should be applied when the facts or circumstances differ. There is an expectation that rejection notices will be carefully considered by preparers.

Educational material is similar in a sense that it is non-mandatory. If the educational material provides guidance on factors to consider, it may be seen as informative. In other cases, if the educational material provides guidance on a particular fact pattern or situation, it may need to be carefully considered. Unlike rejection notices and educational material, which are considered “final” when issued, staff agenda papers are an intermediate step in a process and are preliminary views expressed by the staff. Similarly, there is no suggestion that proposals in exposure drafts be followed.

#### *The Group’s Discussion*

Group members shared a common view that while IFRS Interpretations Committee rejection notices are non-authoritative guidance, it is expected that preparers would carefully consider them, especially if the fact pattern is similar to the situation being contemplated by the preparer. Group members noted that it may be difficult to assess whether an entity’s facts and circumstances align with the specific fact pattern being addressed by the IFRS Interpretations Committee because a limited amount of information is provided in a rejection notice. Alternatively, other factors in the transaction may exist that need to be considered (for example, the preparer’s situation involves more complexity than the factors discussed in the rejection notice). Therefore, the guidance in a rejection notice needs to be assessed together with the specific facts and circumstances of the preparer and the intent of the underlying principles in IFRSs and *The Conceptual Framework for Financial Reporting* in order to determine if the guidance should be applied.

With respect to staff agenda papers and educational materials, Group members observed that this information has not gone through any form of public deliberation, or public scrutiny like rejection notices. It was noted that staff agenda papers are prepared for the purpose of facilitating discussions at the IASB or IFRS Interpretations Committee meetings. While these papers may be useful in following the status and progress of a financial reporting issue, they could potentially be misleading if considered in isolation. Group members emphasized that preparers need to also look at subsequent IASB Updates and IFRIC Updates to obtain a complete and holistic understanding of the views being deliberated. Discussions by the IASB or IFRS Interpretations Committee could lead to a different outcome than what is recommended in a particular staff agenda paper.

Representatives from the Canadian Securities Administrators also shared their perspective that while it is important to consider rejection notices, they are not viewed as definitive. However, if a preparer decides to take a divergent path from the guidance in the rejection notice, staff of the Canadian

Securities Administrators may query the treatment taken. A preparer will need to be able to explain the difference between their specific situation and what is being addressed by the IFRS Interpretations Committee, and support why the selected accounting treatment is appropriate rather than following the guidance in the rejection notice.

The Group's discussion raises awareness about this item and did not recommend any further action to the AcSB. Group members observed that there is currently a challenge for stakeholders to keep up-to-date with published decisions from the IFRS Interpretations Committee. If it is made easier to search and access this information, it would help stakeholders assess the implications of rejection notices on its financial statements on a timelier basis.

***Issue 2: What alternatives might be considered if an entity's current accounting policy is not consistent with sources of non-authoritative guidance such as IFRS Interpretations Committee rejection notices?***

***Fact Pattern:***

For simplicity, the question is considered in the context of the IFRS Interpretations Committee rejection notice. It is assumed that the rejection notice provides clear guidance as to how a standard should be applied in a given set of circumstances and the entity's fact pattern corresponds with the circumstances addressed in the rejection notice.

***For the fact pattern described above, is the entity required to retrospectively change its accounting to conform with the view stated in the rejection notice?***

***View 2A – The entity is not required to retrospectively change its accounting to conform to a view stated in the rejection notice.***

This view is based on the fact that an issue has come before the IFRS Interpretations Committee because there is some ambiguity in the wording of the Standard or how it was intended to be applied. For that reason, preparers may reasonably come to different judgments.

***View 2B – The entity is required to retrospectively change its accounting to conform to a view stated in the rejection notice.***

This view is based on the fact that if the entity's fact pattern is addressed by the rejection notice, the views expressed by the IFRS Interpretations Committee in its rejection notice reflects its interpretation of how the IASB "intended" the Standard to be applied.

***If View 2B is accepted, how should the retrospective change be described (i.e., as a change in accounting policy, a correction of an error, or the change is not labelled?)***

***View 2B.1 – Change in accounting policy.***

This view presumes that the entity's previous accounting treatment was considered a reasonable interpretation of the Standard based on the facts and circumstances and guidance available at that time. It could be argued that the issuance of the rejection notice provides "reliable and more relevant information", which is a criterion in paragraph 14 of IAS 8 in assessing whether it is a change in accounting policy.

*View 2B.2 – Correction of an error.*

This view presumes that the entity's previous accounting treatment was not considered a reasonable interpretation of the Standard based on the facts and circumstances and guidance available at that time.

The IFRS Interpretations Committee staff agenda paper in [February 2012](#) states that “we are unaware of any situation in which an accounting standard setter or its interpretative body has ever branded a change in accounting policy arising from its efforts to clarify its own literature as a correction of an error.” In the end, the IFRS Interpretations Committee staff recommended “the Board affirm that the Committee’s agenda rejection notices are not intended to characterize the accounting practices in question as errors. Rather, that is a judgement that is left to companies, their auditors, and their regulators.”

In the event it is determined that the change arose because of an error, the entity would provide the disclosures required in IAS 8 for a correction of an error.

*View 2B.3 – Change is not labelled.*

This view presumes that it is not immediately clear, in the short period of time since the issuance of the rejection notice, whether the change is a change in accounting policy or a correction of an error.

*The Group’s Discussion*

Group members supported the view that when an entity has determined a change is required as a result of the IFRS Interpretations Committee rejection notice, it should generally be applied retrospectively (unless the rejection notice addressed a matter involving an estimate, wherein the change might be considered a change in estimate). However, Group members observed that since there are no transitional provisions, it is difficult to rule out prospective application even though retrospective application would be more appropriate from a comparability perspective. It was noted that challenges also exist for entities in determining when to make such a change. Preparers are encouraged to wait until the final rejection notice is published but consider whether additional disclosures are needed if tentative agenda decisions appear to have potential implications on currently adopted accounting policies.

Some Group members noted it is important to distinguish if the change is considered an error correction or not. Group members expressed the view that it is difficult to consider the change as an error if the entity's fact pattern is not aligned with the circumstances addressed in the rejection notice, and that the entity had performed its due diligence of applying professional judgment when interpreting the Standard.

On the notion of labelling the change, some Group members expressed support for View 2B.3 because the change is not akin to an error correction or a change in accounting policy. Under this approach, detailed disclosure is critical to explain the rationale behind the retrospective change to the users of financial statements. Other Group members expressed support for View 2B.1 because of new information becoming subsequently available, or that it is closer to a change in accounting policy rather than to leave it unlabelled. One Group member noted that it was unnecessary to distinguish (unless it

was an obvious error) between an error correction and a change in accounting policy as the impact under either scenario would be a retrospective application of the change.

It was noted by a securities regulator that under National Instrument 51-102 *Continuous Disclosure Obligations*, if an issuer has determined that it will retrospectively refile or restate comparative information for reasons other than applying a new or amended standard, or changing an accounting policy, an issuer is required to immediately publish a news release to explain the change. If View 2B.3 is pursued, this is an important consideration to take into account.

Overall, the Group's discussion raises awareness about these items. No further action was recommended to the AcSB. The Group made a general observation that if the rejection notice states that a particular standard is clear, it would help clarify application requirements if the IASB ratifies the conclusions reached by the IFRS Interpretations Committee.

### **IAS 1 and IAS 32: Classification of Debt with Embedded Equity-linked Derivatives**

IAS 1 *Presentation of Financial Statements* contains guidance regarding the classification of liabilities as either current or non-current in an entity's financial statements.

Paragraph 69(d) of IAS 1 states that an entity shall classify a liability as current when "it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period." It further clarifies that the "terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification."

For the purposes of this discussion, the latter portion of paragraph 69(d) of IAS 1 will be referred to as the "clarifying guidance."

Paragraphs BC38E-BC38F in the Basis for Conclusions to IAS 1 provide further background regarding the IASB's decision to add clarifying guidance to amend paragraph 69(d) of IAS 1 as part of its improvement project in 2007. Absent the clarifying guidance, the conversion of a liability into equity would be considered a form of settlement. This means that if the conversion option can be exercised by the holder at any time, the liability component would be classified as current.

Convertible debt is a common type of financial instrument used to raise financing. The terms of a financial instrument may contain elements that are representative of both equity and liability instruments. This instrument, as a whole, would be known as a compound financial instrument and the equity and liability components are accounted for separately.

It should be noted that many conversion features (or other equity-linked features) do not meet the criteria for equity classification because the "fixed-for-fixed" condition in IAS 32 *Financial Instruments: Presentation* is not met, notwithstanding the fact that shares are issued in satisfaction of the holder exercising the conversion feature. However, the Basis for Conclusions to IAS 1 does not contemplate explicitly the situation whereby the conversion (or other equity-linked) feature of a convertible debt instrument is classified as a derivative liability rather than as an equity instrument. The issue that arises is whether the clarifying guidance noted in paragraph 69(d) of IAS 1 regarding the classification of a liability as either current or non-current can also be applied to a hybrid contract that contains a non-

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derivative host component and an embedded derivative component (for example, an embedded derivative liability).

***Issue: May the clarifying guidance in paragraph 69(d) of IAS 1 be applied to convertible debt with a conversion feature that is classified as a derivative liability?***

*View A – Yes, the clarifying guidance in paragraph 69(d) of IAS 1 may be applied.*

Although the Basis for Conclusions to IAS 1 does not specifically contemplate a situation when the conversion feature of the convertible instrument is classified as a liability, the settlement of the conversion feature through the issuance of a variable number of equity instruments rather than a fixed number should not affect the classification of the convertible feature as either current or non-current. In both situations, the derivative liability will be settled through issuance of the entity's own equity.

Further, paragraphs BC38G and BC38H in the Basis for Conclusions to IAS 1 articulate the IASB's position that "information about the liquidity and solvency positions of an entity is useful to users" and that "classifying the liability on the basis of the requirements to transfer cash or other assets rather than on settlement better reflects the liquidity and solvency position of an entity" (emphasis added). Therefore, under this view, it is presumed that the clarifying guidance can be applied because the classification of the shares issued to settle the conversion feature as either liabilities or equity instruments is not relevant.

*View B – No, the clarifying guidance in paragraph 69(d) of IAS 1 may not be applied.*

The clarifying guidance in paragraph 69(d) of IAS 1 was written in the context of a convertible instrument whose conversion feature is classified as an equity instrument as opposed to a liability.

Paragraph BC38E of the Basis for Conclusions to IAS 1 begins by considering the "classification of the liability component of a convertible instrument" and states that "conversion of liability into equity is a form of settlement", both of which could imply that the situation contemplated was in relation to a compound financial instrument when there is a liability component and an equity component. The clarifying guidance refers to "settlement by the issue of equity instruments" (emphasis added), which leads to the question as to whether shares issued in satisfaction of a conversion feature that does not meet the "fixed-for-fixed" condition in IAS 32 are considered "equity instruments."

***The Group's Discussion***

The majority of Group members supported View A, that the "clarifying guidance" in paragraph 69(d) of IAS 1 can be applied by analogy. The rationale is that the derivative liability will not be settled by a cash outflow, but rather will be settled using the entity's own equity even if it violates the "fixed-for-fixed" condition in IAS 32. Therefore, the debt host component of the hybrid contract would be classified as non-current (assuming the other criteria requiring current classification are not met).

One Group member also observed that this perspective can be extended to other similar instruments (for example, a warrant) but noted that complicating circumstances may exist when the instrument could be settled in either shares or cash. In such cases, professional judgment is required to interpret the guidance in paragraph 69 of IAS 1 to determine the appropriate classification.



Some Group members noted there is support for View B in that the “clarifying guidance” was written for equity instruments that meet the “fixed-for-fixed” condition in IAS 32. However, Group members observed that View A could be considered a more sensible approach because if the instrument is classified as current but the settlement does not result in a transfer of cash, View B does not appear to provide meaningful information to users of financial statements.

The Group also discussed that the debt host component of the hybrid contract and the derivative liability should be presented together as a whole such that both components would be classified using the same current or non-current classification.

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

### **IAS 36: Allocating Corporate Costs to a Cash-generating Unit**

IAS 36 *Impairment of Assets* defines recoverable amount as the higher of an asset or cash-generating unit’s fair value less costs of disposal and its value in use. When calculating the value in use, paragraphs 39 and 41 of IAS 36 provide the applicable guidance. The requirements in these paragraphs indicate overheads that are necessarily incurred to generate the cash inflows from the asset or cash-generating unit, and are directly attributable, or can be reasonably allocated to the asset or cash-generating unit, should be included in the cash outflows when calculating its value in use.

When considering corporate costs as an overhead cost, such costs can be broken down into two broad categories:

- costs to provide identifiable services to the entity’s cash-generating units (for example, centralized functions such as information technology that the entity’s cash-generating units utilize to operate); and
- stewardship costs (for example, board of directors’ costs, public company costs, senior officer salaries, etc.).

It is presumed that corporate costs incurred to provide identifiable services to the entity’s cash-generating unit would typically be viewed as necessarily incurred to generate the cash inflows of the cash-generating unit. Therefore, such costs should be allocated to the cash-generating unit in determining its value in use provided that the costs are either directly attributable or a reasonable allocation method exists. However, for stewardship costs, this presumption may differ.

***Issue: Consider stewardship costs and whether such costs should be allocated as a cash outflow in the value in use calculation for a cash-generating unit.***

*View A – Generally, stewardship costs are necessarily incurred to generate the cash inflows of a cash-generating unit and should be allocated to the cash-generating unit (provided an allocation can be done on a reasonable and consistent basis) for purposes of measuring the cash-generating unit’s value in use.*

This view presumes that all costs, including stewardship costs, are necessarily incurred by the entity to operate its business and generate cash inflows, and should be included in the cash outflows of the cash-generating unit when determining value in use. While it could be noted that stewardship costs

and other entity-specific costs may be excluded on the basis that a typical market participant may already have the necessary infrastructure in place to operate the cash-generating unit, the purpose of the value in use calculation in IAS 36 is to consider the present value of all entity-specific cash flows that contribute to the cash inflows of the cash-generating unit.

*View B – Stewardship costs are often not necessarily incurred in order for the individual cash-generating unit of an entity to generate cash inflows and, therefore, should not be allocated to individual cash-generating units when determining value in use.*

This view focuses on the words “necessarily incurred” and presumes that stewardship costs are often not costs that the cash-generating unit must incur to generate inflows (for example, the costs may relate more to capital management and future investment or divestiture decisions). While acknowledging that the value in use calculation is based on entity-specific rather than market participant assumptions, the fact that a market participant may consider a plan to eliminate such costs may suggest the costs are not necessarily incurred to generate the cash inflows of the cash-generating unit.

*View C – Generally, stewardship costs are necessarily incurred to generate the cash inflows of a cash-generating unit. However, an allocation of these costs on a reasonable and consistent basis for purposes of measuring the cash-generating unit’s value in use is often not possible. Therefore, an allocation should not be made.*

This view notes that stewardship costs are often incurred at a significantly higher level within the corporate structure than the level at which the impairment test is being performed. The contribution of such costs to the generation of cash inflows at the lower cash-generating level is so indirect, it could be considered often not possible to allocate stewardship costs on a reasonable and consistent basis to individual cash-generating units.

*View D – Any one of Views A, B or C may be appropriate depending on specific facts and circumstances.*

Under this view, it is noted that the treatment of stewardship costs in determining the value in use of a cash-generating unit is dependent on specific facts and circumstances of the situation and the nature of the costs.

### *The Group’s Discussion*

Group members expressed diverse views on this issue but emphasized that it depends on the nature of the stewardship costs. The Group discussed two important factors to consider when determining whether stewardship costs should be included in the value in use calculation of an asset or cash-generating unit. These two factors are identifying whether the stewardship costs are necessarily incurred to generate cash inflows and if the costs can be reasonably allocated on a consistent basis.

Several Group members tended to favour View A in that generally, stewardship costs are necessarily incurred from the perspective of the entity as a whole (i.e., similar to the concept of corporate assets). Since the entity is comprised of one or more cash-generating units, these costs should be fully allocated to an individual or group of cash-generating units. However, those Group members noted that there could be practical challenges to allocate the stewardship costs on a reasonable and

consistent basis, thus echoing View C, because certain stewardship costs could be incurred at a significantly higher level in order to manage and operate multiple cash-generating units of an entity. It was also questioned whether certain costs such as board of directors' costs, senior officer salaries or public company costs are truly directly attributable to the cash flows of a specific cash-generating unit because these costs would likely still exist even if the asset was sold.

Nevertheless, Group members observed that stewardship costs could be significant in practice. Preparers are encouraged to exercise care when analyzing the nature of stewardship costs to determine whether to include or exclude them in the value in use calculation of a cash-generating unit in order to capture the appropriate amount of cash flows in the model.

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

### **IAS 36: Measuring Recoverable Amount and Allocating Impairment Loss**

#### *Fact Pattern:*

Consider a scenario where the reporting entity has an indefinite-lived intangible asset that does not generate independent cash inflows. An example may include a broadcast licence where the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets is assumed to be the unit that includes both the broadcast equipment and other associated broadcast infrastructure.

Under IAS 36 *Impairment of Assets* an indefinite-lived intangible asset is tested annually for impairment or more frequently if there are indicators of impairment.

In this fact pattern, it is assumed that the fair value less costs of disposal of the indefinite-lived intangible asset is measurable on a stand-alone basis. The value in use of the indefinite-lived intangible asset is not determinable on a stand-alone basis as it does not generate independent cash inflows and is not held for disposal.

Guidance in paragraph 22 of IAS 36 states:

“Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 65-103), unless either:

- (a) the asset's fair value less costs of disposal is higher than its carrying amount; or
- (b) the asset's value in use can be estimated to be close to its fair value less costs of disposal and fair value less costs of disposal can be measured.”

#### *Analysis: How to Test for Impairment of the Indefinite-lived Intangible Asset*

In the fact pattern above, the indefinite-lived intangible asset does not generate independent cash inflows. However, since the indefinite-lived intangible asset's fair value less costs of disposal is measurable, paragraph 22(a) of IAS 36 can be applied to conclude there is no impairment to record if

its fair value less costs of disposal is greater than its carrying value. However, if the indefinite-lived intangible asset's fair value less costs of disposal is not higher than its carrying value, the reporting entity must determine the recoverable amount for the cash-generating unit to which the indefinite-lived intangible asset belongs. Paragraph 22(b) is not applicable because the value in use of the indefinite-lived intangible asset is not determinable.

In addition, if there are other triggers or indicators that require testing the cash-generating unit for impairment to which the indefinite-lived intangible asset is a part of, or that the cash-generating unit contains goodwill that would require an annual impairment test, then the cash-generating unit as a whole must be tested for impairment and the recoverable amount must be calculated. The recoverable amount and the carrying amount of the cash-generating unit are determined inclusive of the intangible-lived intangible asset because it is part of the cash-generating unit. If impairment is identified in the cash-generating unit, the impairment is recognized and allocated to the assets of the cash-generating unit in accordance with the requirements in paragraphs 104 and 105 of IAS 36. Impairment is first allocated to reduce any goodwill amounts within the cash-generating unit. Then, any remaining impairment is allocated to other assets within the cash-generating unit on a pro-rata basis based on their carrying amount. According to paragraph 105 of IAS 36, no asset should be impaired below the highest of its fair value less costs of disposal (if measurable), its value in use (if determinable), and zero.

Therefore, when applying paragraph 105 of IAS 36 to the fact pattern above, if the cash-generating unit to which the indefinite-lived intangible asset belongs is impaired, the allocation of the impairment would not reduce the indefinite-lived intangible asset's carrying value below its fair value less costs of disposal. However, if the fair value less costs of disposal of the indefinite-lived intangible asset was greater than its carrying amount, but the cash-generating unit is being tested for impairment because of other triggers or factors present, no impairment would be allocated to the indefinite-lived intangible asset. Instead, the impairment would be allocated to the other assets of the cash-generating unit on a pro-rata basis.

### *The Group's Discussion*

For the fact pattern presented, Group members discussed a simplified approach containing multiple steps that incorporates the analysis described above on how to test for impairment of the indefinite-lived intangible asset. Group members agreed with the analysis and the application of the requirements in IAS 36.

Group members made some additional observations with respect to the analysis. It was noted that if no other conditions (for example, impairment indicators or goodwill) are present that would trigger the need to test the cash-generating unit for impairment, and if the indefinite-lived intangible asset's fair value less costs of disposal is equal to or above its carrying amount, then no further work is necessary. It was also observed that an entity may need to tailor disclosures if the specific situation (i.e., this fact pattern) does not fit directly into the required disclosures of IAS 36 in order to provide users with transparent information on the assumptions used in the impairment testing. A point was raised that there may be a situation when fair value less costs of disposal for the indefinite-lived intangible asset

might exceed the fair value of the cash-generating unit. However, if this outcome occurred, an entity would need to better understand what is eroding the value of the cash-generating unit.

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

### **IFRS 5 and IAS 36: Impairment Measurement**

IAS 36 *Impairment of Assets* contains measurement guidance when assessing impairment of an asset or a cash-generating unit. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* contain criteria for determining whether an asset can be classified as held for sale.

***Issue: When measuring impairment for an asset or a cash-generating unit that is likely to be sold, but has yet to meet the held-for-sale criteria under IFRS 5, does the calculation of the value in use of the asset or cash-generating unit include the expected sale of the asset or cash-generating unit?***

*View A – The calculation of value in use is based on management's expectations for the asset or cash-generating unit and as such, the measurement of the cash-generating unit should embed the expected sale of the asset or cash-generating unit.*

This view looks to guidance in paragraph 30(a) of IAS 36 that indicates an asset's value in use is calculated based on the estimated future cash flows the entity expects to derive from the asset. It also considers guidance in paragraph 21 of IAS 36, which states that "the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible." When the held-for-sale criteria in IFRS 5 are not met, consideration should be given to the uncertainty in the expected cash flows with regards to whether the asset or cash-generating unit will be sold and the timing of such sale.

*View B – The value in use should be calculated based on the assumption that the entity will continue to use the asset or cash-generating unit through to the end of its useful life.*

This view looks to paragraph 33(a) of IAS 36, which suggests that when calculating the value in use, an entity should include the cash flows expected over the remaining useful life of the asset. This could mean that the use of estimated cash flows assumes the asset or cash-generating unit will be held by the entity throughout its entire life.

This view argues that the discussion in paragraph 21 of IAS 36 is made in reference to IFRS 5 and that it is applicable to the impairment test required immediately before being reclassified to an asset held for sale in accordance with IFRS 5.

#### *The Group's Discussion*

Group members supported the view to include the expected sale of the asset or cash-generating unit in its value in use calculation (View A) because the calculations should reflect the future cash flows that management expects to derive from the asset. A probability-weighted cash flow calculation would be appropriate to reflect the length of time until the asset is expected to be disposed. However, in this situation, an entity is encouraged to revisit its conclusion to ensure that the criteria in IFRS 5 are not met.

One Group member noted that after an entity considers the criteria under IFRS 5, an entity should also determine whether there could be a change in the estimated useful life of the asset under IAS 16 *Property, Plant and Equipment*. The asset should then be assessed to determine if there are any indicators of impairment. In particular, paragraph 12(f) of IAS 36 notes that a significant change to the way in which an asset is used or expected to be used (for example, the asset becoming idle or there are plans to dispose of the asset before a previously expected date) is a trigger for testing impairment.

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

### **IFRS 3, IFRS 6, IFRS 10 and IAS 16: Acquisition of an Entity Holding a Single Asset**

IFRS 3 *Business Combinations* is clear that in a business combination, at the acquisition date, the acquirer shall recognize any non-controlling interest in the acquiree. However, IFRS 3 does not apply to the acquisition of an asset or a group of assets that does not constitute a business, and states that in such cases, the acquirer shall identify and recognize the individual identifiable assets acquired and liabilities assumed.

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

Entity A acquires 80 per cent of the issued shares of Entity B. Consideration is in the form of cash. Entity B has just one asset, the rights to a mineral property in the exploration and evaluation stage. As a result of the transaction, Entity A obtains control of Entity B as defined by IFRS 10 *Consolidated Financial Statements*. The remaining 20 per cent of the issued shares of Entity B are retained by the entity from which Entity A acquired its shares (the seller). This fact pattern assumes Entity B would not be considered an investment entity as defined by IFRS 10.

#### ***Issue: How should Entity A account for the 20 per cent interest it did not acquire?***

***View A – The acquirer should recognize a non-controlling interest for the interest not acquired at fair value.***

IFRS 10 requires that consolidation procedures consist of combining assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries. Entity B holds 100 per cent interest in the mineral property. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that in the absence of an IFRS, management shall first refer to the requirements in IFRSs dealing with similar and related issues. A business combination could be viewed as a similar and related issue and, thus, IFRS 3 could be referred to for guidance.

IFRS 6 *Exploration for and Evaluation of Mineral Resources* requires that exploration and evaluation assets shall be measured at cost. While IFRS 6 does not provide specific guidance on the measurement of cost, IAS 16 *Property, Plant and Equipment* indicates that cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire the asset.

Under this view, the non-controlling interest recognized would be a reflection of the fair value of the interest in Entity B that is not acquired by Entity A. For example, if Entity A paid \$80 for 80 per cent of

Entity B, the non-controlling interest recognized would be \$20, and the asset recorded would be at \$100.

*View B – The acquirer should recognize a non-controlling interest for the interest not acquired at its original cost.*

This view is similar to View A, except that it may be argued since the transaction does not constitute a business combination, the assets and liabilities acquired should be recorded at cost rather than fair value. The cost of the non-controlling interest would be determined based on the carrying amount of the interest in the subsidiary retained by the seller.

*View C – The acquirer should only recognize the cost of the interest acquired.*

Under this view, it could be considered that the substance of the transaction is no different than if Entity A had acquired a direct 80 per cent interest in the mineral property asset. IFRS 3 is clear that when there is an acquisition of an asset or a group of assets that does not constitute a business, the acquirer shall recognize the individual assets acquired. It is considered that Entity A will only receive a future economic benefit from its interest and not the 20 per cent residual interest held by the seller.

IFRS 6 lists examples of expenditures that might be included in the initial measurement of exploration and evaluation assets, which include the cost of the acquisition of the rights to explore. In this fact pattern, the acquirer's rights are comprised of an 80 per cent interest in a mineral property, regardless of whether or not the rights are held directly or through a separate entity that holds the asset. Under this view, only the cost of the 80 per cent interest should be recorded.

*View D – The IFRS guidance is unclear and there is an accounting policy choice.*

It could be viewed that IFRSs do not specifically address whether or not a non-controlling interest should be recognized and, if recognized, how it should be measured, on the acquisition of an entity holding a single asset that does not constitute a business. As a result, IAS 8 would require an accounting policy be developed that best reflects the nature of the transaction based on the facts and circumstances.

### *The Group's Discussion*

The majority of Group members supported the view that the acquirer should recognize the non-controlling interests of the subsidiary at fair value (View A). There is clear guidance in IFRS 10 that requires an acquirer to recognize the percentage of non-controlling interest when it consolidates the acquiree. Therefore, View D is not applicable. The Group discussed View B, which differs from View A in that the amount of non-controlling interest would be recorded at cost instead of at fair value. While it was acknowledged that this specific fact pattern would not be within the scope of IFRS 3 as the acquisition does not constitute a business, most Group members expressed the view that it would be difficult to support recognizing non-controlling interest at cost because there is a control premium that should be considered. It was further noted that if the acquiree's carrying amount was used as a measurement basis, a pro-rata approach to record the non-controlling interest at cost could result in the acquirer recording the subsidiary in excess of its fair value, which does not seem reasonable.

Therefore, most Group members supported the view of recognizing the non-controlling interest at fair value as the preferred practice and cautioned the use of the approach under View B.

Group members noted that View C (i.e., the acquirer should only recognize the cost of the interest acquired), would be adopting a “look-through” approach that in general is not supported within the principles of IFRSs. One Group member also noted that the economic substance is different when a legal structure is setup to hold the asset compared to holding an asset directly. Therefore, View C would not be considered appropriate.

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

### **IAS 16: Capitalization of Costs**

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation commences at the same point in time.

IAS 16 *Property, Plant and Equipment* requires qualifying assets to be initially recognized at cost. Some assets are acquired or constructed over time.

Paragraph 16 of IAS 16 specifies the cost of an item includes, among other things, “any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.” Paragraph 20 of IAS 16 provides guidance on when capitalization ceases and paragraph 55 of IAS 16 provides guidance on when depreciation commences.

#### ***Issue: What is meant by the phrase “to be capable of operating in the manner intended by management” in the context of ceasing capitalization and commencement of depreciation?***

*View A – Management may use a pre-determined operating level as a criterion to establish when to cease capitalizing costs.*

Paragraph 20 of IAS 16 requires that costs be capitalized until the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management. This would suggest management is required to set out its expectations for how the asset will be operated (for example, when operating at a certain capacity threshold). It is argued that this view would not violate the prohibition against the capitalization guidance regarding full capacity in paragraph 20(a) of IAS 16 because the asset is not capable of being operated in the manner intended by management until a base level of operations is achieved.

*View B – Capitalization of costs ceases when the asset can create the output that it was designed to produce on a regular basis even if this is not necessarily at the levels originally planned by management.*

Under this view, it is noted that IFRSs do not contain explicit guidance on how to determine when an asset is capable of being operated in the manner intended by management. As a result, it could be argued that management’s intentions with respect to capacity levels are not relevant to the



determination of whether an asset is “capable of operating in the manner intended by management.” Rather, the “manner intended by management” should be judged by whether the asset is in the location and condition to function properly (for example, when testing is complete and the intended product or output can be created).

*View C – A policy choice is available.*

It could be argued that IFRSs do not contain explicit guidance on how to interpret the phrase “in the manner intended by management” and, therefore, both View A and View B have merit.

### *The Group’s Discussion*

Group members expressed varying views on this issue and noted that the guidance is not clear.

One Group member suggested that current use of a policy similar to View A is based on pre-changeover Canadian GAAP, specifically EIC-27 *Revenues and Expenditures During the Pre-operating Period*, which looked to activity levels, among other factors, when determining whether a new business is ready to commence commercial operations.

Conceptually, there was support for View B because the approach in View A is subjective and involves a considerable amount of judgment. It was noted that it would be difficult to achieve consistency and comparability among entities if management sets a pre-determined threshold for ceasing capitalization based on their own expectation of how the asset will operate. It was also observed that disclosure becomes critical to provide users with transparency into management’s decision because depending on the threshold selected, it could yield significantly different accounting results.

Some Group members noted that it would be difficult to completely support View B without giving consideration to some measure of determining when the testing phase of the asset is complete and when the production stage has been entered. It was noted that specific facts and circumstances of a situation will also have an impact on making such a determination. Therefore, in many instances, it is a judgment call to determine when testing of an asset has been completed (for example, by producing a minimum amount of output to derive a reasonable level of economic benefit from the asset) and when the output produced is part of ongoing production.

A few Group members also noted that consideration should be given to whether certain components of the asset are already in the location and condition necessary for it to be capable of operating in the manner intended by management before others.

The Group noted that this is a significant issue across various industries (for example, mining, oil and gas) and thinks that there is diversity in practice. Currently, the IFRS Interpretations Committee is considering the issue of when an asset is available for use as part of addressing a submitter’s issue on the “Accounting for Proceeds and Costs of Testing on Property, Plant and Equipment.”

The Group thinks that adding clarifying guidance around when an asset is available for use (i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management) in context of the full requirement would be beneficial to achieve consistent application. The Group recommended that the AcSB should share the members’ views on this issue regarding how to consider the phrase “to be capable of operating in the manner intended by management” with the

IFRS Interpretations Committee for their consideration as part of its current work on the submitter's issue.

### **IAS 16 and IAS 38: Revenue-based Amortization**

The IASB has issued narrow-scope amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* to clarify that the use of a revenue-based depreciation and amortization method is not appropriate; however, that presumption is rebuttable for intangible assets. The amendments are effective for annual periods beginning on or after January 1, 2016. Earlier application is permitted.

Revenue-based amortization is commonly used in the media sector in respect of TV program rights, movie production, and sports broadcasting rights. It is also used by entities that develop or acquire libraries of data that are in turn licensed to others, such as seismic data and maps, as well as by certain software developers, such as producers of video games. In certain jurisdictions, revenue-based amortization is also used to account for the amortization of intangible assets arising out of service concession arrangements, particularly when the tariff charges are lower in the initial years and much higher in the later years.

Paragraph 98A of the amended IAS 38 states:

“There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:

- (a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or
- (b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.”

Paragraph 98B of the amended IAS 38 further states:

“In choosing an appropriate amortisation method in accordance with paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (ie time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.”

### *The Group's Discussion*

Group members were asked whether they are aware of other industry sectors or circumstances in which revenue-based amortization is used in practice. No comments were raised with respect to identifying other industry sectors being affected.

Group members were also not aware of circumstances in which intangible assets are expressed as a measure of revenue such that revenue-based amortization would be appropriate.

In discussing the rebuttable presumption, Group members agreed that if the appropriate correlation analysis cannot be made, revenue-based amortization is precluded and an alternative method of amortization is required. It was noted that professional judgment is required to demonstrate how revenue and consumption of the economic benefits of the intangible asset are highly correlated given that there is no guidance in IAS 38 as to how to demonstrate that correlation. An entity would also need to identify and consider the predominant limiting factor that is inherent in the intangible asset to determine an appropriate basis of amortization. Other methods of amortization such as units of production, declining balance or sum of the digits method of amortization may be supportable.

The Group's discussion raises awareness about this item and Group members noted that it may be too early to determine potential application issues. The Group recommended no further action to the AcSB at this time but commented that it may be worthwhile to have a future discussion on this topic if application issues start to arise in this area.

### **IAS 16: Depreciation of Spare Parts, Stand-by Equipment and Servicing Equipment**

*Annual Improvements 2009–2011 Cycle*, issued by the IASB in May 2012, amended paragraph 8 of IAS 16 *Property, Plant and Equipment* to state that “items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this IFRS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.” The amendments were effective for annual periods beginning on or after January 1, 2013.

Based on the amendments, if spare parts, stand-by equipment and servicing equipment are expected to be used during more than one period, they would be classified as property, plant and equipment. If they are not expected to be used during more than one period, they should be treated as inventory. Materiality judgments are often considered when deciding how spare parts, stand-by equipment and servicing equipment are accounted for.

When spare parts are classified as property, plant and equipment, the question of when to commence depreciation becomes evident. Paragraph 55 of IAS 16 states that “depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.”

#### ***Issue: When should depreciation commence for a spare part?***

*View A – Depreciation should begin when the spare part is available to be used.*

Consideration may be given to whether a spare part is only “on stand-by”, that is, the spare parts may be major items and parts critical to be kept on hand to ensure uninterrupted operation of production

equipment. These are often referred to as “critical spares” or “insurance spares” in the mining industry. If the spare part is “available for use” when an identical item stops working, it could be argued that depreciation should commence. The depreciation period would start immediately over the lesser of its useful life, and the remaining expected useful life of the equipment to which it is associated.

*View B – Depreciation should begin when the spare part is put into use.*

If major spare parts are not considered critical, the timing of depreciation may differ. For example, if the spare part is expected to be used as a replacement part at a future point in time, the spare part will be installed and put into use at a later date. Depreciation commences when it is installed as a replacement part. These types of items are often referred to as “capital spares” in the mining industry.

### *The Group’s Discussion*

Group members noted that in determining when depreciation commences for a spare part, an entity needs to consider the underlying nature of the spare part (i.e., if it is considered a “critical spare” or “capital spare”). One important factor to consider is whether there is a reasonable expectation that the spare part will be used in order to determine when the service potential is being consumed. For critical spares, Group members noted that the service potential is being consumed over time because in the event of an emergency breakdown, the spare part will function immediately. For capital spares, there is a reasonable expectation that it will be put into use such that the service potential starts to be consumed when it is installed. Therefore, Group members concluded that when depreciation commences for a spare part depends on the underlying nature of the spare part.

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

### **IFRS 13 and IAS 39: Fair Value Measurement of Government Loans**

Starting in April 2008, the Department of Finance launched its centralized borrowing program, under which some of the Crown corporations who used to issue debt instruments on public markets (namely Farm Credit Canada, Federal Business Development Bank and Canada Mortgage Housing Corporation) would, from then on, obtain all of their financing exclusively from the Government of Canada. Any other source of financing contemplated would require authorization from the Minister of Finance. It should be noted that Export Development Canada was not included in this program and still borrows on public markets, given its requirement for foreign currencies. These Crown corporations are government business enterprises that prepare financial statements in accordance with IFRSs.

The objective of centralizing Crown corporation financing was to provide these entities with a more cost-effective source of financing because this enables them to borrow at the rate obtained by the Government of Canada, whereas the rates obtained on the market were slightly higher.

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 refers to paragraph AG76 of IAS 39 when the transaction price differs from the fair value.

Paragraph AG76 of IAS 39 specifies that the best evidence of fair value is normally the transaction price. However, if it is determined that the transaction price does not correspond to the fair value at initial recognition, the instrument should be recorded at:

- (a) the measurement required by paragraph 43 of IAS 39 “if the 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,” with the difference between the transaction price and fair value being recognized as a gain or loss; or
- (b) at the measurement required by paragraph 43 of IAS 39, “adjusted to defer the difference between fair value at initial recognition and transaction price,” if fair value is not based solely on observable data.

Paragraph 9 of IFRS 13 *Fair Value Measurement* defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

Paragraph 22 of IFRS 13 states that “an entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming the market participants act in their economic best interest.”

Paragraph B4 of IFRS 13 also provides guidance in determining whether a transaction price can or cannot be assumed to reflect fair value at initial recognition (for example, considering if the transaction is between related parties and if the entity has evidence that the transaction was entered into at market terms).

***Issue: How do IAS 39 and IFRS 13 affect the measurement of such debt instruments upon initial recognition?***

*View A – Fair value of the instrument at initial recognition should be determined using management’s best estimate of the interest rate the corporation would pay had it issued its debt on a public market to non-related market participants.*

Under this view, the applicability of paragraph B4 of IFRS 13 is considered. It is recognized that the shareholder, the Government of Canada, is not at arms’ length and is providing a benefit to its participating Crown corporations via a lower borrowing cost. Thus, the transaction price does not reflect fair value of the financial liability for these entities.

Paragraph 10A of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* provides further guidance. This paragraph indicates that the benefit of a government loan at a below-market rate is treated as a government grant, with the loan then being recognized and measured in accordance with IAS 39. The benefit of the below-market interest rate is measured as the difference between the initial carrying value of the loan determined in accordance with IAS 39 and the proceeds received.

The interaction between IAS 39 and IFRS 13 would suggest that these Crown corporations are expected to use a valuation technique and determine assumptions, most importantly the interest rate based on observable data on the market and management's best estimates to determine fair value.

*View B – Fair value of the instrument at initial recognition should be determined as the transaction price.*

This view focuses on the notion of the market when assessing the issue.

Paragraph 18 of IFRS 13 indicates that if there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market even if the price in a different market is potentially more advantageous at the measurement date. Then, paragraph 19 of IFRS 13 states that the entity must have access to the principal (or most advantageous) market at the measurement date. This could suggest that since the entity would not have access to any other market other than the market made up solely by its shareholder, the Government of Canada, the transaction occurring in this market is a reflection of fair value.

Paragraph 45 of IFRS 13 provides further guidance in relation to the existence of restrictions. Such restrictions should not be separate inputs into the fair value determination as it is assumed that the terms of the instrument factors in an adjustment for the restriction. In this case, it could be considered that the lower interest rate that the Crown corporation benefits from is the result of accepting the imposed restriction of non-transferability and dealing solely within the centralized borrowing program for its source of funding.

The argument under this view is that since there is no market for these instruments, no observable market data exists. Given the restrictions on these instruments (i.e., they are not transferable and the Crown corporations cannot obtain financing from other sources without ministerial authorization), there is no other source of observable inputs for fair value measurement other than the transaction price.

### *The Group's Discussion*

With respect to this specific fact pattern, Group members expressed support for View B that the fair value of the instrument is the transaction price. It was clarified that if a Crown corporation obtained ministerial approval to obtain financing from an alternative source, the debt would still be guaranteed by the government. As such, it could be observed that the loan is at the market rate of the government, which is being passed through to the Crown corporation and that the lower interest rate is a benefit resulting from imposed restriction of non-transferability. Group members noted it would be difficult to look at a different market to estimate the fair value because the Government market is the only market that these Crown corporations can trade in (unless ministerial approval is sought).

It was observed that if this fact pattern was substituted with a situation where a parent company is providing a below-market loan to its subsidiary, the economics of the transaction would be different such that View A would be applied.

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

## IFRS 13 and IAS 39: Subsequent Measurement of Fair Value

Paragraph 43A of IAS 39 *Financial Instruments: Recognition and Measurement* states that if the fair value of a financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG76 of IAS 39.

Paragraph AG76 of IAS 39 does not permit an entity to initially recognize an upfront gain or loss if the valuation technique uses unobservable inputs to measure fair value and the instrument has to be measured at the transaction price. In this case, any differences between fair value and transaction price at initial recognition are deferred off-balance sheet and recognized if certain conditions are met.

If an entity recognizes, for example, a financial liability that meets the criteria to be classified at fair value through profit or loss, the entity would then recognize changes in fair value that occur subsequent to initial recognition in profit or loss.

### *Fact Pattern:*

- On December 23, 2014, Entity A recognizes a financial liability at \$1,000, which is equivalent to the consideration received;
- Entity A used a valuation technique to measure the fair value of the financial liability at initial recognition and determined that its fair value was \$1,200;
- Entity A is prohibited from recognizing the \$200 loss on initial recognition because the valuation technique uses unobservable inputs. It would defer off-balance sheet the valuation technique-derived \$200 loss;
- On December 31, 2014 (which is Entity A's year end), it is required to measure the financial liability at the then fair value, with changes in fair value recognized in earnings (assuming the financial liability is not part of a hedging relationship). Entity A uses the same valuation model to measure the financial liability at year end and the result is that the financial liability's fair value has decreased by \$100 (i.e., the valuation technique-derived fair value is now \$1,100).

### ***Issue: How is the initial transaction price and fair value differential recognized (if at all)? Is there a limit on the recognition of any other changes in fair value?***

*View A – Calibrate the valuation technique so that the initial recognition equals the transaction price. Apply the revised valuation technique consistently throughout the life of the financial instrument. Any subsequent gains or losses due to changes in market shall be recognized in earnings to the extent it arises from a change in factor (including time) that market participants would consider in setting a price.*

Paragraph AG76 of IAS 39 indicates that the best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. Unless an entity meets one of the factors described in paragraph B4 of IFRS 13 *Fair Value Measurement*, it is highly unlikely that the transaction price resulting from non-related parties transacting at arm's length will not equal fair value.

This view considers whether the valuation technique employed is appropriate. If it is, the entity may modify one or more of the input assumptions in the model such that the fair value generated, as a

whole, results in an amount equal to the transaction price for the transaction. The entity then uses that revised valuation process for that instrument on a consistent and appropriate basis both at its inception and throughout its life. Any subsequent changes in the fair value determined by that valuation technique would be recognized in earnings as they arise.

*View B – Treat the difference between the initial valuation technique result and transaction price as an illiquidity adjustment. Use a rational method to recognize the illiquidity adjustment in earnings over time.*

This view presumes that the difference between the results of the valuation technique that uses unobservable inputs and the transaction price is an illiquidity adjustment. The illiquidity adjustment would not be recognized shortly after inception. Instead, the entity would determine the amount of the illiquidity adjustment for the affected instrument and determine a rational method to recognize that adjustment (for example, over the term of the instrument). If management has concluded the valuation technique continues to be appropriate, the entity should use that valuation technique to estimate the fair value of the instrument on an ongoing basis. Any changes in fair value of the instrument from inception, excluding the illiquidity adjustment, would be recognized in earnings.

### *The Group's Discussion*

The Group noted that it is important to understand what is driving the differences between transaction price and fair value and whether all elements of the transaction have been taken into consideration in the valuation model.

Some Group members also noted that this situation arises in other circumstances (for example, hybrid contracts when volatility is a significant unobservable input). One Group member noted that the views presented are not necessarily opposing views, but rather are paths to be taken in regards to discrete situations.

If it is concluded that the transaction price is fair value, then the predominant view that Group members supported is View A, which is to calibrate the valuation technique so that the initial recognition equals the transaction price and apply the revised valuation technique subsequently until the unobservable input becomes observable. Some Group members thought there may be circumstances when View A would not apply because the transaction price does not equal fair value. Then View B would be considered in determining how to take the pricing difference into earnings over time.

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

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

### **IFRS 11: Joint Arrangements**

In November 2014, the IFRS Interpretations Committee published a series of [tentative agenda decisions](#) on application issues related to IFRS 11 *Joint Arrangements* that it had discussed between November 2013 and July 2014. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period on January 20, 2015 if they had any concerns with



the tentative agenda decisions published. The Group discussed the topic of IFRS 11 at various meetings between October 2012 and September 2014.

## **OTHER MATTERS**

### **Rate-regulated Activities**

On September 17, 2014, the IASB issued a [Discussion Paper](#) exploring what information about rate-regulated activities is most useful to users of financial statements and the possible approaches to reporting the financial effects of rate regulation. Canadian stakeholders were encouraged to submit their comments to the IASB by January 15, 2015. In addition, the AcSB hosted an IASB roundtable on this Discussion Paper in Toronto on December 12, 2014.

### **IFRS 15: Revenue from Contracts with Customers**

At the September 2014 IFRS Discussion Group meeting, it was mentioned that an [IASB/FASB Joint Transition Resource Group for Revenue Recognition](#) has been established to address potential implementation issues. The Group has had two meetings to date to discuss potential issues arising from the implementation of the new Standard. The AcSB will be monitoring the work of the Joint Transition Resource Group, to which a Canadian representative has been appointed.

### **IAS 19: Longevity Swaps, Annuity Buy-in and Buy-out and Discount Rate**

In November 2014, the IFRS Interpretations Committee published a tentative agenda decision on the accounting for longevity swaps held under a defined benefit plan and concluded that it did not expect diversity in the application of IAS 19 *Employee Benefits*. The IFRS Interpretations Committee understands the predominant practice is to account for a longevity swap as a single instrument, and measure it as fair value as part of plan assets. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period on January 20, 2015 if they had any concerns with the tentative agenda decision.

Another aspect of employee benefits that has been a recent topic of discussion is how to consider annuity buy-ins and buy-outs. A view exists that the purchase of an annuity buy-in potentially represents plan assets and the purchase of an annuity buy-out potentially results in a settlement of the obligations and related plan assets for all or part of the defined benefit plan.

On the concept of discount rates, there have been discussions as to whether an entity can segregate the defined benefit liability into different groups (for example, active members, pensioners, etc.).

Stakeholders are encouraged to stay abreast of the employee benefit discussions in these areas.

### **IAS 16: Accounting for Proceeds and Costs of Testing on Property, Plant and Equipment**

At the September 2014 IFRS Discussion Group meeting, it was mentioned that the IFRS Interpretations Committee received a request to clarify the accounting for net proceeds received during the course of testing an item of property, plant and equipment. In July 2014, the IFRS Interpretations Committee issued a tentative agenda decision to indicate that the excess net proceeds should be recognized in profit or loss. In November 2014, the IFRS Interpretations Committee discussed the comment letters

received on the tentative agenda decision and noted a number of concerns and practical issues were raised. As a result, this item was added to its agenda for further analysis. Stakeholders are encouraged to follow the [status](#) of this issue.