IFRS Discussion Group

Report on the Public Meeting

May 14, 2015

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 a summarized version of the Group's discussions during the meeting. For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips.

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

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ITEMS PRESENTED AND DISCUSSED AT THE MAY MEETING

IAS 1: Disclosure Initiative Amendments

In December 2014, the IASB issued "*Disclosure Initiative* (Amendments to IAS 1)" as part of a wider project to improve the presentation of, and disclosures in, financial statements.

The amendments made to IAS 1 *Presentation of Financial Statements* are designed to address concerns expressed by constituents about existing presentation and disclosure requirements. The changes to IAS 1 are only intended to clarify existing requirements. The amendments also encourage entities to use judgment in the application of IAS 1 when considering the layout and content of their financial statements.

The amendments made to IAS 1 relate to:

- materiality and aggregation;
- information to be presented in the statement of financial position and statement of profit or loss and other comprehensive income;
- the structure of the notes to the financial statements; and
- the disclosure of accounting policies.

The amendments are effective for annual reporting periods beginning on or after January 1, 2016. Early application is permitted.

Amendments relating to materiality and aggregation

The amendments clarify that information is not to be aggregated or disaggregated in a manner that obscures material information or reduces understandability of financial statements. Materiality considerations apply to the complete set of financial statements. If a standard contains specific minimum disclosure requirements, preparers still need to assess whether each required disclosure is material and would warrant presentation or disclosure of such information. Preparers should also consider account items both individually and collectively because a group of immaterial items may be material when combined. Further, additional disclosures should be considered to the extent that specific requirements in IFRSs do not provide users of financial statements with an understanding of a particular transaction.

Amendments relating to information presented in the primary financial statements

The amendments clarify that the requirements to present specific line items in the primary financial statements (i.e., the statement of financial position and statement(s) of profit or loss and other comprehensive income) can be met by disaggregating these line items if this is relevant to an understanding of the entity's financial position and performance. Subtotals, in addition to those required by IFRSs, must be made up of items recognized in accordance with IFRSs and need to be presented and labelled in a manner that is understandable and consistent from period to period. The additional subtotals are not permitted to be displayed with more prominence than the subtotals and totals required by IFRSs.

Amendments relating to the structure of the notes

The amendments clarify that entities have the flexibility to change the order of the notes to the financial statements. The notes do not necessarily need to be presented in the order listed in previous paragraph 114 of IAS 1. Instead, amended paragraph 114 of IAS 1 includes examples of systematic ordering or grouping of the notes, such as giving prominence to the areas of an entity's activities that it considers to be most relevant to the understanding of financial performance and financial position or grouping together information about items measured similarly.

Amendments relating to the disclosure of accounting policies

The amendments remove the examples related to accounting policies for income taxes and foreign exchange gains and losses in previous paragraph 120 of IAS 1. As mentioned in the Basis for Conclusions, the IASB thought it was unclear why a user of financial statements would always expect these specific policies to be disclosed.

The Group's Discussion

Group members were asked whether they anticipate significant changes in practice as a result of the amendments.

Group members did not expect a drastic change in the way information is reported because entities have adopted a balanced approach in the use of aggregation and subtotals and in general, are applying good practices in Canada. Preparers are encouraged to apply professional judgment in deciding what information is needed and how best to present or disclose it in the financial statements. As a result, it is important for a preparer to consider the structure of the note disclosures to identify redundant information, along with considering what is relevant or material to improve the understandability of financial statements for users.

Group members recognized that there will be individuals averse to making changes due to concerns around possible regulatory repercussions or the cost and effort it takes to assess what information is considered material. It is understandable that preparers may tend to include more information to avoid questions from both regulators and auditors. The representatives from the Canadian Securities Administrators (CSA) commented that they hope the clarifications to IAS 1 will result in appropriate changes to financial statements and that preparers are comfortable applying the necessary professional judgment. They also viewed the amendments to be consistent with the CSA Staff Notice 52-306 (Revised) "Non-GAAP Financial Measures and Additional GAAP Measures."

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

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

IAS 19: Discount Rates

According to IAS 19 *Employee Benefits*, the rate used to discount post-employment benefit obligations reflects the estimated timing of benefit payments. In practice, entities often apply a single weighted average discount rate that reflects the estimated timing of benefit payments when calculating the

defined benefit obligation, interest cost and current service cost for a defined benefit plan. This practice is referred to as the “traditional approach.”

With improvements in computer power and modelling programs, it is possible for calculations to be undertaken on a more granular basis. Four possible alternative approaches to the traditional approach have been recently discussed in practice: a split discount rate approach; a yield-curve approach; a mixed approach; and a vector approach.

Under a split discount rate approach, the plan is separated into different categories of plan members (for example, pensioners and active members). A single weighted average discount rate is determined using the traditional approach for each category of member to calculate its respective defined benefit obligation, interest cost and current service cost, if applicable.

A yield-curve approach applies the discount rates from the yield curve that match the expected timing of benefit payments (i.e., the spot rates for each individual time band) to calculate the defined benefit obligation and current service cost.

Under a mixed approach, the current service cost is calculated using the split discount rate approach or the yield-curve approach to give consideration to the different categories of members. However, the defined benefit obligation and interest cost are calculated using the traditional approach.

The vector approach relates only to the interest rate used to calculate interest cost and would be applied in combination with any of the other three approaches. Under this approach, the interest cost is calculated by applying the one-year forward rate to the defined benefit obligation at the beginning of the period.

Issue: Which of the approaches outlined above are consistent with the discount rate requirements in IAS 19?

View A – Traditional approach only.

This view considers paragraph 85 of IAS 19 to require a single weighted average discount rate. Measurements under IAS 19 are expected to be inherently imprecise, thus changing the discount rate adds undue complexity.

View B – Traditional approach and split discount rate approach.

This view considers both approaches to be acceptable under IAS 19. The split discount rate approach is considered to be a refinement to the requirements in IAS 19 because it provides more accurate and better information. It gives consideration to the fact that payments to active employees tend to be further in the future than payments to pensioners. Thus, separating the plan calculations into different categories of participants would yield more accurate estimates of the current service cost and would be a refinement in the calculation of pension expense.

View C – Traditional approach, split discount rate approach and yield-curve approach.

This view considers the yield-curve approach to be another acceptable method. If benefits are uniformly attributed across the expected service lifetime of employees (which is generally the case under the projected unit credit method), the yield-curve approach would result in the same outcome as

the split discount rate approach calculated on a granular basis. However, if benefits are not uniformly attributed across the expected service lifetime of employees, the outcome of the yield-curve approach may be different than performing separate calculations for each individual. If the yield-curve approach is applied, when the stratified sections of the plan's population are aggregated for disclosure purposes, it appears as though different discount rates have been applied to calculate the defined benefit obligation and current service cost for the entire plan.

View D – Traditional approach, split discount rate approach, yield-curve approach and mixed approach.

This view considers a mixed approach such as calculating the current service cost using the split discount rate approach but calculating the defined benefit obligation and interest cost using the traditional approach. Under this view, a mixed approach may result in more accurate information.

The Group's Discussion

Group members observed that the terminology used by the actuarial community may be different than that used for the approaches described above. The focus of the discussion was to first determine whether an approach other than applying a single weighted average discount rate is permissible under IAS 19. If Group members thought an alternative approach is permitted under IAS 19, the question of whether a resulting change would be considered a change in accounting policy or change in estimate may be discussed by the Group at a future meeting. The defined benefit obligation would be the same under all the approaches described above, but there could be a difference in the amount recognized in profit or loss and other comprehensive income or loss.

Group members noted that IAS 19 does not appear to preclude the use of alternative approaches. They tended to support the use of the split discount rate approach because for each category of plan member, the same discount rate is used to calculate the three components (i.e., defined benefit obligation, current service cost and interest cost). However, one Group member noted that there could be practical challenges in terms of how to apply the split discount rate model to a funded plan's assets for the purposes of the net interest calculation. These challenges arise because the investments are not split by category of plan member and, thus, it would be difficult to segregate the plan assets into different groups. A concern with the yield-curve or mixed approach was that a different discount rate is being used to calculate the three components. Group members noted that the vector approach was not permissible based on the wording of IAS 19. Overall, Group members emphasized it is important to look at the underlying details of any model given the potential terminology differences to understand if the calculations are aligned with the requirements in IAS 19 and if the model is being applied consistently from period to period. If a different discount rate approach is used, it is also important to understand the effects it will have on the components of defined benefit cost.

Group members observed that this issue is not unique to Canada and that different practices are emerging in the United States and Europe. There are ongoing discussions at the U.S. Securities and Exchange Commission about the use of alternative approaches in calculating a discount rate and what the related implications are. The IASB also has a research project related to accounting for all post-employment benefits plans including new pension plan design. In addition, the Public Sector

Accounting Board sees pensions as an important topic and their work may have an effect on the private sector.

Given the various channels of work on pensions, the Group recommended not raising this issue to the IASB or the IFRS Interpretations Committee at this time but monitoring the issue for future developments.

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

IAS 36: Recoverable Amount

Paragraph 78 of IAS 36 *Impairment of Assets* states that "it may be necessary to consider some recognised liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability." An example could be a decommissioning liability.

The Group first considered whether a decommissioning liability is required to be included in the carrying and recoverable amounts of a cash-generating unit (Issue 1). Assuming the decommissioning liability is included in the carrying and recoverable amounts of the cash-generating unit, the focus is then on the application of paragraph 78 of IAS 36. The Group considered whether the difference between the discount rate used to measure the decommissioning liability, and the discount rate used to measure the recoverable amount of that cash-generating unit, should be addressed (Issue 2).

The Group discussed a related issue (IFRS 3, IFRS 13 and IAS 37: Asset Retirement Obligations Assumed in a Business Combination or Asset Purchase) at its June 12, 2014 meeting. The issue was regarding the likelihood of a material difference arising between the fair value of an asset retirement obligation assumed in a business combination that is determined in accordance with IFRS 13 *Fair Value Measurement*, and the measurement value resulting from the application of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. In that meeting, Group members observed there can be a material difference due to the different treatment of credit risk between IFRS 13 and IAS 37.

Issue 1: Is a decommissioning liability required to be included in the carrying and recoverable amounts of a cash-generating unit to which the liability relates?

View A – A decommissioning liability is required to be included in the carrying and recoverable amounts of a related cash-generating unit.

This view considers that a market participant would be required to assume the cost of decommissioning a property if a purchase was to take place. Therefore, the requirements in paragraph 78 of IAS 36 would apply.

View B – Inclusion of a decommissioning liability in the carrying and recoverable amounts of a cash-generating unit is dependent on specific facts and circumstances.

This view considers that while it is very common for a market participant to assume the cost of decommissioning a property, a review of specific facts and circumstances is required to determine if it is expected or required by local legislation.

The Group's Discussion

Group members supported the view that it depends on specific facts and circumstances of a situation (View B). In practice, decommissioning liabilities are generally included, but it is not always the case. Therefore, it is important to have a rationale for including or excluding the decommissioning liability when calculating the carrying and recoverable amounts of a related cash-generating unit.

Issue 2: Assuming that a decommissioning liability is included in the carrying and recoverable amounts of a cash-generating unit, does a discount rate mismatch arise between the rate used to measure the decommissioning liability and the rate used to measure the recoverable amount of that cash-generating unit?

Paragraph 36 of IAS 37 states that "the amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period." IAS 37 does not require the use of fair value, but rather is based on the best estimate of the provision. The rate used to discount the provision reflects current market assessments of the time value of money and the risks specific to the liability. The question is whether an entity's own credit risk is considered a risk specific to the liability. This requirement differs from the fair value principle in IFRS 13 because the fair value of a liability reflects the effect of non-performance risk, which explicitly states that it includes an entity's own credit risk. This suggests that there may be a policy choice in IAS 37 on whether to include or exclude an entity's own credit risk in the calculation.

According to IAS 36, an asset or cash-generating unit's recoverable amount is the higher of its fair value less costs of disposal and its value in use. Fair value less costs of disposal is based on the fair value principle in IFRS 13 (which includes an entity's own credit risk). Value in use is based on a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The view of whether a discount rate mismatch arises depends on if the entity included credit risk in measuring the decommissioning liability under IAS 37, and the method used to calculate the recoverable amount of the cash-generating unit that is inclusive of the decommissioning liability under IAS 36.

The Group's Discussion

One Group member observed that IAS 37 does not contain a policy choice on whether or not to include credit risk in the discount rate when measuring liabilities. Instead, as noted by the IFRS Interpretations Committee in its March 2011 agenda decision, IAS 37 does not explicitly state whether or not an entity's own credit risk should be included in the discount rate. The IFRS Interpretations Committee noted that the predominant practice is to exclude own credit risk, which is generally viewed in practice as a risk of the entity rather than specific to the liability.

Another Group member noted that whether there is a discount rate difference that would affect impairment depends on how the recoverable amount of a cash-generating unit is being calculated. Paragraph 78 of IAS 36 indicates that if the recoverable amount is calculated as fair value less costs of disposal, the unit of account is inclusive of the liability. This would suggest that a discount rate mismatch could arise and affect the amount of impairment recorded when the recoverable amount

reflects fair value less costs of disposal. The Group member noted that the discount rate used to measure the fair value of the liability would include credit risk, whereas the discount rate used to measure the carrying value of the liability may or may not include credit risk. However, if the recoverable amount is calculated as value in use, the carrying value of the liability is deducted from both the carrying and recoverable amount of the cash-generating unit. The deduction of the carrying value of the liability from both amounts suggests that a discount rate mismatch would not exist and, therefore, not affect the amount of impairment recorded when the recoverable amount reflects value in use.

When it comes to testing the cash-generating unit for impairment based on fair value less costs of disposal, other Group members were not overly concerned that a significant difference would be created if credit risk was excluded in the measurement of the decommissioning liability. Often in an impairment model test, there are many assumptions that affect the precision of the estimate derived. Even if a potential discount rate difference exists, the effect is not expected to be important given a range of estimates exist in an impairment model test.

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

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

IAS 39: Classification of Exchanged Shares

Some entities in the exploration stage in the mining industry are facing challenges in raising capital through issuing common shares for cash. As a result, certain of these entities have turned to using alternative financing transactions. A form of financing transaction that has been used by a number of entities in the exploration stage (exploration entity) is the issuance of common shares in exchange for shares of another entity (financing entity).

Fact Pattern

The financing entity is a closed-end investment company. Concurrently with the exchange of shares, the financing entity lists its shares on a stock exchange. This fact pattern assumes that the purpose of the transaction is to provide the exploration entity with the ability to generate cash for its operations through the subsequent sale of the financing entity's shares. The financing entity's shares are initially subject to resale restrictions that are in place for approximately six months. These restrictions include a requirement that any share sales are approved by the financing entity.

Issue: Do the financing entity's shares meet the criteria in IAS 39 to be classified as held for trading and, therefore, at fair value through profit or loss?

IAS 39 *Financial Instruments: Recognition and Measurement* requires financial assets to be classified into one of four categories at initial recognition: financial assets at fair value through profit or loss; held-to-maturity investments; loans and receivables; and available-for-sale.

From the perspective of the exploration entity, the financing entity's shares clearly do not meet the criteria for classification as held-to-maturity investments, or loans and receivables. In determining whether the financing entity's shares should be recognized at fair value through profit or loss, it

depends if they meet certain conditions in paragraph 9 of IAS 39, one of which is whether the shares are classified as held for trading.

View A – Yes, the financing entity's shares meet the criteria for being classified as held for trading.

This view considers that the exploration entity's main purpose to enter into such transaction is to raise cash in the short term. Since the intention is to sell the shares in the near term, the investment should be classified as held for trading and, therefore, at fair value through profit or loss.

View B – No, the financing entity's shares do not meet the criteria for being classified as held for trading.

Paragraph AG14 in IAS 39 states that "trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margins." This view considers that the intention to acquire the financing entity's shares is to raise cash to support ongoing operations as opposed to generating profits from short-term fluctuations.

Furthermore, the shares are subject to resale restrictions and, thus, the exploration entity's ability to sell these shares is limited in some manner. Paragraph 9 of IAS 39 indicates that if investments in equity instruments do not have a quoted market price in an active market, and the fair value cannot be reliably measured, the investment cannot be designated at fair value through profit or loss.

The Group's Discussion

Most Group members supported the view that the financing entity's shares do not meet the criteria for being classified as held for trading because the resale restriction affects the ability to sell the shares in the near term (View B). The Group also clarified that in the fact pattern being considered, there is no requirement to sell the financing entity's shares. The possibility of View A was discussed given there is no definition on what constitutes "near term" in IAS 39. While Group members noted that professional judgment is required to determine whether the shares were acquired for the purpose of selling in the near term, some members thought that the six month resale restriction posed some difficulty in this fact pattern. Group members observed that although the specific facts and circumstances may vary, there are limited instances of this type of transaction in the market.

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

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

IAS 39: Classification of Cash and Cash Equivalents

IAS 39 *Financial Instruments: Recognition and Measurement* requires financial assets to be classified into one of four categories at initial recognition: financial assets at fair value through profit or loss; held-to-maturity investments; loans and receivables; and available-for-sale. Paragraph 9 of IAS 39 contains the relevant guidance.

In practice, cash and cash equivalents are generally classified as loans and receivables or financial assets at fair value through profit or loss.

Issue: What category best reflects the measurement of cash and cash equivalents?

View A – Cash and cash equivalents are classified as held for trading and, therefore, measured at fair value through profit or loss.

This view presumes that cash and cash equivalents are acquired for the purpose of selling or repurchasing in the near term. As the turnover of cash and cash equivalents is relatively quick (less than three months for cash equivalents and daily for cash), these amounts meet the criteria as held for trading in paragraph 9 of IAS 39 and, thus, should be measured at fair value through profit or loss.

View B – Cash and cash equivalents are classified as loans and receivables and, therefore, measured at amortized cost.

This view considers that cash and cash equivalents are not actively marketed or destined for sale. Cash simply represents a deposit with a financial institution. Cash equivalents are considered similar to cash because they are readily convertible to a known amount of cash. There is an insignificant risk of changes in value and, thus, these amounts should be measured at amortized cost.

The Group's Discussion

Most Group members supported the view that cash and cash equivalents should be classified as loans and receivables and, therefore, would be measured at amortized cost (View B). Paragraph AG26 in IAS 39 includes deposits held in banks as an example that could potentially meet the definition of loans and receivables. Group members observed that the classification of cash could also depend on specific facts and circumstances. For example, one Group member noted that cash held in a vault or on site could be different from deposits held in a bank. Another member also noted that certain instruments classified as cash equivalents may not meet the definition of loans and receivables and, thus, there could be a different classification between cash and cash equivalents. In general, the Group observed that many practitioners are not overly concerned with the classification of cash and cash equivalents as the implications to the financial statements would not be viewed as significant.

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

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

IFRS 9: Transition

The IASB issued the final version of IFRS 9 *Financial Instruments* in July 2014, being IFRS 9 (2014). The changes include a simplification of the classification and measurement of financial assets, an introduction of a single forward-looking impairment model for credit losses and revisions to hedge accounting.

The Group discussed the implications of adopting IFRS 9 (2014) and focused on four areas: the date of initial application; transition for classification and measurement; transition for impairment; and transition for hedge accounting.

Date of initial application

The date of initial application is important because it is the date at which several key assessments are made. Some key assessments include assessing the objective of the business model within which financial assets are held and designating an equity investment that is not held for trading as at fair value through other comprehensive income. There are also other assessments such as designating or revoking designations of financial instruments measured at fair value through profit or loss and assessing whether presenting the effects of changes in a financial liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. The date of initial application is also the date at which all necessary hedging documentation must be in place. Further, if an entity chooses not to restate its prior period comparatives, opening retained earnings is adjusted in the annual period containing the date of initial application.

Transition for classification and measurement

IFRS 9 (2014) is generally applied retrospectively, but there are certain exceptions. For example, an entity does not need to restate prior periods but may do so if it is possible without using hindsight. There is also a limited reopening of the fair value through profit or loss option. IFRS 9 (2014) contains specific transition requirements for items such as the assessment of the business model and solely payments of principal and interest condition, investments in equity instruments, fair value option designations, and hybrid contracts.

Transition for impairment

IFRS 9 (2014) introduces a single forward-looking impairment model. There are two measurement bases, being the 12-month expected credit losses or the lifetime expected credit losses. The basis that would be used depends on whether there has been a significant increase in credit risk since the financial asset's initial recognition. An entity shall apply the impairment requirements retrospectively, with certain exceptions.

Transition for hedge accounting

Changes on hedge accounting include a new fair value option model for managing credit risk, an alternative fair value option model for certain own-use contracts and additional disclosure requirements regarding an entity's risk management and hedging activities. Entities can choose to adopt IFRS 9 (2014) but continue hedge accounting under IAS 39 *Financial Instruments: Recognition and Measurement* until the completion of the IASB's macro hedging project. Hedge accounting is generally applied prospectively, with some exceptions. Hedge documentation must be in place at the date of initial application.

The Group's Discussion

Group members observed that it is still premature for companies to decide whether to apply IFRS 9 (2014) early, although some have already applied IFRS 9 that was issued by the IASB in November 2013 to take advantage of the opportunities related to hedge accounting. The Office of the Superintendent of Financial Institutions has mandated the domestic systemically important banks (i.e., the six largest banks) in Canada to early adopt IFRS 9 (2014). In terms of restating comparatives,

entities are looking at other jurisdictions to see what choices are being made. Stakeholders are reminded that entities generally have to apply IFRS 9 (2014) retrospectively (except for hedge accounting). Therefore, the relief from restating comparatives is only in respect of the presentation of financial statements, not the quantification of the transition adjustments.

With respect to classification and measurement, Group members observed a potential challenge is identifying the scope of the financial instruments to be tested against the classification conditions (for example, the level of granularity when looking at portfolios). Also, consideration needs to be given to what thresholds or indicators should be used in making assessments related to the business model and solely payments of principal and interest condition. Another potential challenge is the complexity of certain financial instruments. If there are many added features, it raises a concern as to whether the solely payments of principal and interest condition can be met. Also, there could be deferred tax implications if an entity changes a measurement basis of a financial instrument.

In terms of the impairment model, Group members observed that it may be too early to identify significant challenges. However, with a forward-looking expected loss model, an increased involvement from other departments, such as credit, is likely needed in making certain accounting assessments.

As for hedging, there are some perceived benefits in terms of being able to hedge additional risk exposures. Although the changes are meant to align more with risk management strategies, there is still a lot of complexity in the requirements that would require careful assessment.

The Group's discussion raises awareness about the item. At this point, no further action is recommended to the AcSB but the Group will continue to monitor for future application issues.

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

IFRS 9: Hedge Accounting

The Canadian and U.S. natural gas markets operate as one large integrated market. Canadian gas production is connected to the North America gas market through a network of pipelines that allows buyers to purchase and transport natural gas from a number of supply sources across North America. The price of natural gas is made up of three parts: the commodity cost, the transportation cost and the distribution cost. Generally, the transportation and distribution costs are regulated by government agencies and tend to change moderately over time. The commodity cost makes up most of the final cost to consumers, which can be volatile as it changes in response to supply and demand conditions.

The primary pricing point of natural gas in North America is the Henry Hub in Louisiana. As a result of its pipeline connections to high consuming regions in the United States, there are futures contracts based on Henry Hub trades (NYMEX HH) on the New York Mercantile Exchange (NYMEX). The Alberta Energy Company C hub (AECO) in Southeast Alberta is the main Canadian pricing point. AECO contracts are traded on an exchange and clearing agency in Alberta (NGX).

Natural gas traded under NYMEX HH and AECO contracts have the same physical characteristics. NYMEX HH contracts are quoted in U.S. dollars and bought and sold in millions of British thermal units. AECO contracts are quoted in Canadian dollars and bought and sold in gigajoules. Therefore, a fixed conversion factor is used to convert the standard energy unit used in the respective regions.

AECO is priced as a basis (i.e., differential) to NYMEX HH. The basis represents regional differences in supply and demand and considers the cost to transport the natural gas. Changes in the Canada-U.S. exchange rate also affect the price of natural gas in Canada. The key difference between AECO and NYMEX HH is the physical delivery point of the natural gas under the respective standard contracts. AECO contracts traded on NGX are commonly delivered to a pipeline in Alberta, whereas NYMEX HH standard contracts require delivery to the Henry Hub in Louisiana. As a result, AECO is often trading at a price lower than NYMEX HH to reflect the cost of transporting natural gas from Western Canada to the high consuming regions in the East. However, it can also be priced above NYMEX HH.

As a result of larger volumes being traded on NYMEX, the liquidity premiums of entering into contracts at NYMEX are often lower than the premiums paid on NGX, thus reducing the costs of economic hedging. Therefore, AECO price exposures are often hedged with NYMEX HH denominated hedge instruments.

Paragraph B6.3.9 in IFRS 9 *Financial Instruments* states:

> "When identifying what risk components qualify for designation as a hedged item, an entity assesses such risk components within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. Such a determination requires an evaluation of the relevant facts and circumstances, which differ by risk and market." (emphasis added)

Issue: Is NYMEX HH a non-contractually specified risk component of AECO, as defined under IFRS 9?

View A – Yes, NYMEX HH is a non-contractually specified risk component of AECO.

This view is based on the fact that the Canadian and U.S. natural gas markets operate as one large integrated market. Local supply and demand has only a limited effect on the differential between the various traded prices. Most of the price differential is related to transport.

NYMEX HH is a component of AECO on the basis that under the pricing convention for forward contracts, the AECO price is determined relative to NYMEX HH. Once the forward contract reaches its maturity, the differential is converted to the actual AECO spot price for settlement.

Entities employing a risk strategy of using NYMEX HH derivatives to hedge a risk component of natural gas purchases or sales are hedging only a particular risk component and not hedging other risk components. The reason for this is driven by the liquidity of the NYMEX HH contracts as compared to AECO contracts and the related cost savings when utilizing NYMEX HH derivatives rather than AECO derivatives.

View B – No, NYMEX HH is not a risk component of AECO.

This view considers that even though there is an integrated natural gas pipeline network in North America, there are still two significant natural gas markets. The differential between the two market prices is a result of differences in demand and supply of gas within the respective markets. Therefore, the NYMEX HH price and the AECO price are benchmark prices of different markets. Although there is

a high correlation between the market prices, the NYMEX HH price is not considered a risk component of the AECO price.

The Group's Discussion

A few Group members commented on this issue and various views were expressed. An observation was made that the Canadian and U.S. natural gas markets could be seen as one large integrated market and, thus, there is an economic relationship between NYMEX HH and AECO. However, some other points were raised for further consideration. For example, if NYMEX HH is identified as a specific risk component of AECO, a foreign exchange risk component exists and creates further considerations on determining whether there is a hedging relationship. Another point was raised regarding the application of hedge accounting when the component is more than the total cash flows of the entire item (i.e., when the NYMEX HH price is above the AECO price, a negative differential exists) given the requirements in paragraph B6.3.21 of IFRS 9. Also, another factor to consider is the measurement of AECO, and whether it is possible to measure it separately from NYMEX HH because of the larger traded volumes and liquidity in the NYMEX market.

The Group's discussion raises awareness about the item. It was observed that there are ongoing global discussions. No further action is recommended to the AcSB.

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

IFRS 15: Transition

The IASB issued IFRS 15 *Revenue from Contracts with Customers* in May 2014 and the standard is converged with ASU 2014-09 Topic 606, the U.S. GAAP equivalent standard.

IFRS 15 establishes a single comprehensive framework for revenue recognition that replaces all previous revenue standards and related interpretations. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this principle, a five-step model for revenue recognition is introduced:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

As of the mandatory effective date, IFRS 15 will have to be retrospectively applied. Appendix C of the standard contains two possible transition methods that can be used in applying the standard. These two methods are referred to in the Group's discussion as follows:

- the "full retrospective" method, subject to a number of practical expedients; and

- the “modified retrospective” method with the cumulative effect of initially applying the standard recognized at the date of initial application.

Regardless of the transition method applied, entities may have to change accounting policies and apply the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* more broadly.

Transition Methods

Under the full retrospective method, an entity recognizes the cumulative effect of applying IFRS 15 at the start of the earliest comparative period presented as an adjustment to opening retained earnings and retrospectively adjusts each comparative period presented in its financial statements.

To ease transition under this method, paragraph C5 of IFRS 15 states:

> “An entity may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph C3(a):
>
> (a) for completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period;
>
> (b) for completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods; and
>
> (c) for all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue (see paragraph 120).”

Paragraph C3(a) of IFRS 15 is referring to the full retrospective method. If practical expedients are used under this method, an entity shall disclose additional information to explain which expedient has been used, and to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Under the modified retrospective method, an entity recognizes the cumulative effect of applying IFRS 15 as an adjustment to opening retained earnings at the date of initial application without restating the comparative periods presented. Under this method, IFRS 15 is only applied retrospectively to contracts that are not completed as of the date of initial application. However, since comparative figures are not restated, specific disclosures are required to help users of financial statements understand the effect on trend information.

Considerations given to each transition method

There are both advantages and disadvantages to each of the transition methods. Therefore, entities will have to carefully assess the merits and drawbacks to determine which approach is best based on their specific circumstances. The following are some points for consideration.

An advantage of the full retrospective method would be having a more complete depiction of financial performance and greater comparability. Also, there are a number of practical expedients that are available for use that may ease transition under this method. However, this could be seen as a disadvantage as the use of expedients could reduce comparability. Another disadvantage would be the need to obtain a larger population of contracts to perform the assessment over. It could be difficult to obtain historical information, and may likely increase the associated time and preparation costs.

An advantage of the modified retrospective method would be analyzing and assessing a smaller population of contracts (i.e., all contracts that are completed as of the date of initial application do not need to be reassessed). Also, there is no requirement to restate comparative period figures, thus reducing the volume of information that may need to be obtained. A disadvantage would be limited comparability among periods. Although additional disclosures are required in order to facilitate a level of comparability for the user, these disclosures may require an entity to maintain two sets of records, systems, etc. and could result in significant efforts.

The Group's Discussion

Group members agreed that the summary regarding the transition methods described above is consistent with their understanding of the requirements.

Group members observed that the IASB/FASB Joint Transition Resource Group for Revenue Recognition has discussed several practical application challenges associated with this new revenue standard. These issues are being brought forward and deliberated by the IASB and FASB. As a result, it is expected that proposed amendments will be issued in the near future. One amendment could be including a transition practical expedient that would permit the application of hindsight in accounting for contract modifications. As well, both Boards have tentatively decided to defer the effective date of the standard by one year, to annual reporting periods beginning on or after January 1, 2018 with early adoption permitted, to allow more time to address these application challenges.

Group members commented that there is not enough focus on IFRS 15 because stakeholders are possibly underestimating the implications of this new revenue standard and delaying the assessment given an expected deferral in the effective date. Group members encouraged stakeholders to start early to assess the effect that IFRS 15 will have on their financial statements and give consideration to how the Management's Discussion and Analysis may be affected.

The Group's discussion raises awareness about the item. At this point, no further action is recommended to the AcSB but the Group will continue to monitor for future application issues.

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

Definition of a Publicly Accountable Enterprise

The Preface of the CPA Canada Handbook – Accounting explains that publicly accountable enterprises apply IFRSs in Part I of the Handbook. The Preface provides a definition of a publicly accountable enterprise that consists of two criteria. Meeting either one of these criteria satisfies the definition. The AcSB's definition was largely based on the corresponding definition proposed by the IASB of public accountability (found in the *International Financial Reporting Standard for Small and Medium-sized*

Entities). It was also based on the AcSB's experience with non-publicly accountable enterprises when developing and maintaining Section 1300, *Differential Reporting*, in the pre-changeover standards in Part V of the Handbook.

The definition of a publicly accountable enterprise, as stated in paragraph 3(a) of the Preface states:

> "A publicly accountable enterprise is an entity, other than a not-for-profit organization, that:
>
> (i) has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
>
> (ii) holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.
>
> Banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks typically meet the second criterion above. Other entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, co-operative enterprises requiring a nominal membership deposit, or sellers that receive payment in advance of delivery of the goods or services, such as utility companies), that does not make them publicly accountable."

The marketplace has evolved such that there are new types of entities emerging that have non-traditional structures in terms of raising capital (for example, crowd funding) or being structured as an investment (for example, closed-end funds).

Crowd funding is the raising of funds through the collection of small contributions from the general public using the Internet and social media. More recently, the concept of crowd funding has been extended to raise money for commercial purposes, often to fund the development of singular projects (for example, products which have reached a certain stage of design and development, but require additional funding to be brought into commercial production).

Closed-end funds refer to a type of investment fund that is non-redeemable. Closed-end funds may be structured as investment or mutual funds, or as corporations or capital trusts. They are created to attract funds for collective investment, and are managed with specific investment strategies and goals. Unlike open-end funds, investors are unable to directly redeem the net asset value of their investments. Instead, liquidation must occur through wind-down of the fund or through sale of the closed-end fund units to third parties.

The Group's Discussion

Group members observed there are factors to consider when determining whether an entity meets the definition of a publicly accountable enterprise. These factors include whether it can be supported that there is a public market, whether the investors are considered a broad group of outsiders, and whether the entity is holding assets in a fiduciary capacity as one of its primary businesses. Group members noted that there is no bright-line test in applying the definition, thus judgment is required. However,

there are resources available to assist in making such determination. For example, there are Q&As published by the SME Implementation Group on the interpretation of terms such as "traded in a public market" and "public accountability".

An observation was made that entities raising capital in non-traditional markets appear to be blurring the distinction between private and public enterprises. It appears that complications arise when assessing these non-traditional structured entities over a period of time. A few Group members expressed some comments for consideration. For example, comments were made on whether the assessment of an "outsider" would change when an individual starts to receive detailed project updates after investing in the entity, and whether the platform used for raising capital would continue to exist to facilitate public market trading. Another comment was made about the need to consider the motive of the investor involved in these non-traditional forms of raising capital to determine if the entity has fiduciary responsibility. For example, are these investors expecting a return such that it lends towards an equity model or do they only want to see this value proposition succeed such that it is like a donation-type model? It was also noted that the four Parts of the CPA Canada Handbook – Accounting were created to serve the needs of users that have a different purpose in the way they use financial statements. Thus, it is important to consider what the financial reporting objective is of these non-traditional structured entities and the effect that objective would have on their users.

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

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IAS 16: Capitalization of Costs

At the December 2014 meeting, the Group recommended the AcSB share the Group members' views on how to consider the phrase "to be capable of operating in the manner intended by management" with the IFRS Interpretations Committee for their consideration. This input is related to the issue the IFRS Interpretations Committee is currently addressing about "Accounting for Proceeds and Costs of Testing on Property, Plant and Equipment."

At the May 2015 meeting, it was reported that the AcSB agreed with the Group's recommendation and a conference call was arranged with the staff of the IFRS Interpretations Committee in early January 2015 to provide this input. The AcSB staff also provided further support by connecting the staff of the IFRS Interpretations Committee with the Mining Industry Task Force on IFRSs and Oil & Gas Industry Task Force on IFRSs to conduct further outreach activities.

Discussions at the IFRS Interpretations Committee are still ongoing and the AcSB staff will continue to monitor the status of their deliberations.

OTHER MATTERS

IFRS 15: Revenue from Contracts with Customers

The IASB/FASB Joint Transition Resource Group for Revenue Recognition has held four meetings to date to discuss potential issues arising from the implementation of the new revenue standard. The IASB and FASB have been jointly discussing the implementation issues identified by this Transition Resource Group, and the potential effects on IFRS 15 *Revenue from Contracts with Customers*.

Both the IASB and FASB tentatively decided to defer the effective date of the new standard by one year to annual reporting periods beginning on or after January 1, 2018 with early adoption permitted, subject to feedback on the proposals. One of the reasons for the proposed deferral is that the IASB is planning to issue an exposure draft of targeted amendments to the standard to clarify the issues identified by the Transition Resource Group. Stakeholders are encouraged to monitor the status of this project.

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

The IFRS Interpretations Committee directed its staff to prepare a draft interpretation on the meaning of "testing" the property, plant and equipment. This includes focusing on clarifying when an asset is "functioning properly", and what indicators (for example, technical or physical measures) signify that the asset is doing so. Given it is important for users to understand the effect on the financial statements, additional disclosure requirements (such as the amount of proceeds that have been deducted from the property, plant and equipment) are also expected. Stakeholders are encouraged to follow the status of this issue.

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