IFRS® Discussion Group

Report on the Public Meeting

January 10, 2019

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

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

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

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

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ITEMS PRESENTED AND DISCUSSED AT THE JANUARY MEETING

IFRS 16 and IAS 34: Disclosing the Effects of Adopting the Leases Standard

At its October 2017 meeting, the Group discussed what entities should consider when disclosing the effects of adopting the new standards, IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, in interim financial statements.

The Group discussed several issues:

1. Is an opening statement of financial position required in Q1-2018 interim financial statements if the effect of adopting the new standards:

   (a) on a retrospective basis is immaterial; or

   (b) on a modified retrospective basis is material?

2. What financial instrument and revenue-related disclosure requirements apply to Q1-2018 interim financial statements prepared in accordance with IAS 34 *Interim Financial Reporting*?

3. When a reporting issuer's accounting policies under the new standards have not changed relative to Q1-2018, can the reporting issuer cross-reference to the accounting policies in the Q1 interim financial statements from its Q2 and Q3 interim financial statements?

For this meeting's discussion, Group members discussed any updates or changes in views on the above issues in the context of adopting IFRS 16 *Leases*. IFRS 16 is effective for reporting periods beginning on or after January 1, 2019.

Issue 1: Are there updates or changes in views around the need for an opening statement of financial position upon the adoption of a new standard such as IFRS 16?

Analysis

From an IFRS Standards perspective, paragraph 40A of IAS 1 *Presentation of Financial Statements* provides guidance on whether an entity is required to present a third statement of financial position at the beginning of the preceding period. There is no explicit requirement for an opening statement of financial position in IAS 34.

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

At its October 2017 meeting, the Group noted the following:

- **For a new standard that permits adoption on a retrospective basis.** If an entity adopts this approach and the effect on the statement of financial position is immaterial, an opening statement of financial position as at the date of adoption is not required. It would be prudent to disclose this fact in the notes to the financial statements.
- **For a new standard that permits adoption on a retrospective basis without prior period comparatives restated.** If an entity adopts this approach and the effect on the statement of financial position is material, an opening statement of financial position is not required. The rationale is that doing so would negate the effect of adopting a modified retrospective approach for transition.

The Group's Discussion

Group members agreed that the same thought process as discussed at its October 2017 meeting (see above) should be followed to determine whether an opening statement of financial position is needed upon the adoption of IFRS 16.

A representative of the Canadian Securities Administrators (CSA) reiterated that there is no materiality threshold related to the requirement for an opening statement of financial position in Section 4.3(2)(d) of NI 51-102 when an entity applies an accounting policy retrospectively. However, in cases where the opening statement of financial position was not included because the application of the new accounting policy change has no material effect on the opening statement of financial position, it is unlikely that any regulatory action will be taken as a result of the omission.

Issue 2: A reporting issuer adopts IFRS 16 on January 1, 2019. For its Q1-2019 interim financial statements prepared in accordance with IAS 34, what are the expectations for disclosures of the new leases standard?

Paragraphs 15 to 16A of IAS 34 provide requirements around significant events and transactions in the context of interim financial reporting. Paragraph 16A of IAS 34 specifies what additional information should be included in the notes to the interim financial statements if it is material, unless it is disclosed elsewhere in the interim financial report. IAS 34 was not amended because of the issuance of IFRS 16 to include new disclosure requirements.

View 2A – No specific disclosure requirements apply.

IAS 34 is the relevant guidance for disclosures in the interim financial statements. Since it was not amended upon the issuance of IFRS 16, no new interim disclosures are required.

View 2B – The disclosure requirements in paragraphs 51 to 60 of IFRS 16 (for lessees), paragraphs 89 to 97 of IFRS 16 (for lessors) and the transition disclosures in Appendix C apply.

Proponents of this view look to the requirement in paragraph 15C of IAS 34 when assessing the extent of disclosures needed. Given the significance of adopting IFRS 16, all disclosures under IFRS 16 are required in the first interim financial statements.

Appendix C of IFRS 16 sets out specific disclosures relating to the transition to IFRS 16 (i.e. transition methods and practical expedients applied). Given their unique transitional status, these disclosures are also applicable to the first interim financial statements after adopting IFRS 16.

At the October 2017 meeting, Group members thought that this view was the starting point for addressing the adoption of the financial instruments and revenue standards. However, Group members also noted that the thought process described in View 2C could also be used in the analysis.

View 2C – The level of additional disclosures provided in the first interim financial statements after adopting IFRS 16 varies depending on an entity's specific circumstances. Applying paragraph 15C of IAS 34 requires judgment to determine what to disclose and when to disclose it.

This view is consistent with the discussion at the January 2013 meeting when the Group considered whether all the disclosures required by IFRS 12 *Disclosure of Interests in Other Entities* must be provided in the first interim financial statements after adopting IFRS 12. At that meeting, Group members supported providing only the disclosures required by IAS 34, which include some of the IFRS 12 disclosures.

At the October 2017 meeting, most Group members noted that it is important to provide users with information to help them understand the changes in an entity's financial position or performance since the last annual reporting period. Therefore, the thought process described in View 2B should be considered in the analysis.

The Group's Discussion

From a practicality perspective, some Group members supported providing all the disclosures required under IFRS 16 in Q1-2019 if the standard is expected to have a material impact on the entity (View 2B). In addition, one Group member thought that this approach would be helpful in providing investors with sufficient information to update their models for the effects of adopting IFRS 16.

Other Group members supported applying judgment to determine what relevant disclosures are needed in Q1-2019 to help users understand the effects of adopting IFRS 16 (View 2C). In their view, the starting point would be to consider all the annual disclosures in IFRS 16 and then to apply judgment to assess what condensed disclosures are meaningful to users to comply with paragraph 15C of IAS 34. Furthermore, while the underlying economics of the lease contracts have not changed, IFRS 16 changes how these contracts are reflected in the financial statements. Therefore, certain information such as a maturity analysis of the lease liabilities may be relevant to users.

A CSA representative echoed the Group's comments about the need to provide users with information to help them understand the changes in an entity's financial position or performance since the last annual reporting period. Since IFRS 16 is a new major accounting standard, there should be robust disclosures in Q1-2019 to communicate the effects of adoption. Entities should take materiality into consideration and exercise appropriate judgment in providing relevant disclosures to users.

Issue 3: A reporting issuer adopts IFRS 16 on January 1, 2019. For its Q2 and Q3-2019 interim financials statements, can the reporting issuer cross-reference to the Q1-2019 interim financial statements when applying paragraph 16A(a) of IAS 34 if its accounting policies under IFRS 16 have not changed relative to Q1-2019?

Paragraph 16A(a) of IAS 34 requires:

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

For a reporting issuer adopting IFRS 16 on January 1, 2019, the first discussion of new accounting policies and methods under the new standards is included in the Q1-2019 interim financial statements and not in the most recent annual financial statements (i.e., year ending December 31, 2018).

Paragraphs 51 to 60 of IFRS 16 require extensive disclosures, including:

- the expense relating to leases of low-value assets accounted for applying paragraph 6 of IFRS 16;
- total cash outflows for leases;
- the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset; and
- maturity analysis of lease liabilities.

View 3A – No.

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

Proponents of this view note that the above does not contemplate IAS 34 interim financial statement for an earlier interim period. Therefore, the reporting issuer's disclosures in Q1-2019 of new accounting policies and methods applied since the 2018 year-end financial statements, as contained in the Q1-2019 interim report, are repeated in the Q2 and Q3-2019 interim reports.

View 3B – Yes.

Unlike View 3A, proponents of this view think that the phrase "some other statement" is not restricted to items such as management commentary or risk reports as these are just examples rather than an exhaustive list. Provided that the Q1-2019 interim financial report is available to users on the same terms as the Q2 and Q3-2019 interim financial reports and at the same time, cross-referencing is appropriate. These criteria are typically met when the earlier period interim financial report is in the public domain (e.g., available on SEDAR[1]).

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1 SEDAR is the System for Electronic Document Analysis and Retrieval, the electronic filing system for the disclosure documents of issuers across Canada.

In addition, this view is generally consistent with practice in 2018 with the adoption of the financial instruments and revenue standards.

The Group's Discussion

Group members conceptually supported View 3B that for its Q2 and Q3-2019 interim financial statements, a reporting issuer can cross-reference to its Q1-2019 interim financial statements. However, several Group members commented that, from a practicality perspective, it is easier for users to obtain all the information in one place, therefore supporting View 3A. One Group member noted that interim financial statements already refer to the last annual financial statements, so it could add a level of complexity to direct users to other documents. Another Group member also commented that repeating information that has not changed from Q1 in the Q2 and Q3 interim financial statements is also easier than cross-referencing from a preparer's perspective. This approach has been commonly observed in practice with the adoption of the financial instruments and revenue standards.

A few Group members discussed that sometimes the information in Q1 is not always the same in Q2 or Q3 because there could be changes in an entity's leasing activities. However, if an entity only has one building lease, the disclosures likely would not change from one quarter to the next. Therefore, in this case, cross-referencing may be more appropriate to reduce repetition.

One Group member commented that it is important not to include too many disclosures that would mask other relevant information in the interim financial statements.

Overall, the Group's discussion of the three issues raises awareness about what disclosures may be required in interim financial statements after adopting IFRS 16. No further action was recommended to the AcSB.

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

IFRS 16: Scope Exemption for Non-regenerative Resources

In Canada, the government generally owns all minerals and rights over those minerals beneath the ground, while individuals and entities own freehold ownership interests over the surface of the land. In mining and oil and gas industries, an entity may acquire from the government a licence to drill, mine or explore for minerals, on property that a third party owns. To access such minerals, the entity would need to enter into a separate contractual arrangement with the land owner, which grants the entity the right to access the surface of the land which contains the minerals (commonly called "land-access agreement").

Paragraph 3(a) of IFRS 16 *Leases* states that "an entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources."

The Group considered the following rights to determine whether they would be in scope of the leases standard.

Fact Pattern

- **Right #1 – Right to explore.** Entity A obtains a permit from the government that provides it with the right to explore for oil within a tract of Land Y for 20 years. Entity A pays an annual fee to the government for the permit to explore for the oil.
- **Right #2 – Agreement with private landowner for right to access land.** To explore for the oil contained within Land Y, Entity A also obtains the right to access the surface of Land Y from a private owner of the land that contains the resources.
- **Right #3 – Right to use equipment to explore and extract.** To extract the oil from Land Y, Entity A enters into a lease for drilling equipment. The drilling equipment will be used exclusively in the extraction of the oil on Land Y throughout the entire lease term.

Issue: Does the scope exemption in paragraph 3(a) of IFRS 16 apply to all or only some of the rights in the fact pattern?

View A – The scope exemption applies only to Right #1.

Under this view, paragraph 3(a) of IFRS 16 should be applied narrowly to only those leases that give an entity a permit or right to explore for or use minerals, oil, natural gas and similar non-regenerative resources.

View B – The scope exemption applies to Rights #1 and #2.

Proponents of this view consider the words "leases to explore for or use minerals" to include leases that provide the right to explore and/or extract minerals. Therefore, the right to explore for minerals, oil, natural gas or similar non-regenerative resources (Right #1) and right to access the surface of the land in which the minerals are contained (Right #2) are captured by those words.

Proponents of this view also look toward guidance in U.S. GAAP. The Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 842, *Leases*, states that the leasing standard does not apply to:

> [l]eases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources (see Topics 930, Extractive Activities – Mining, and 932, Extractive Activities – Oil and Gas). This includes the intangible right to explore for those natural resources and rights to use the land in which those natural resources are contained (that is, unless those rights of use include more than the right to explore for natural resources), but not equipment used to explore for the natural resources. (ASC 842-10-15-1(b))

View C – The scope exemption applies to all rights (i.e., Rights #1 to #3).

Proponents of this view take a broad prospective of what is eligible for the scope exemption. Paragraph 3(a) of IFRS 16 is not specific to just the mineral right or land access agreement that provides access to the mineral. Any lease of equipment used in the extraction process falls within the scope exemption because it is required to explore for or use the minerals.

The Group's Discussion

Most Group members supported View B that the scope exemption in IFRS 16 should be applied to both Right #1 and Right #2. Some Group members supporting View B noted that both the right to explore for the mineral and the right to access the surface of the land that contains the mineral are required to carry out the extractive work. Therefore, the scope exemption should extend to the land leases as well. One Group member thought that the scope exemption is only meant to exclude the mineral right and that the right to access the land is no different than other land leases. Therefore, this Group member preferred View A. However, another Group member highlighted that the land has value from the mineral it contains, and therefore, would qualify under the scope exemption.

The Group briefly discussed an example of a single arrangement that encompassed both an equipment lease and the right to access the land. Some Group members commented that the various components embedded in a single arrangement should be bifurcated and evaluated separately against the scope exemption.

Several Group members observed that some diversity in practice may exist in the Canadian oil and gas industry in applying the scope exemption related to surface rights beyond those highlighted in the fact pattern. An example would be surface rights related to certain activities to process the resource into a condition necessary for it to be transported, and whether the scope exemption should be applied separately to such surface rights to use land beyond accessing the minerals.

The Group also discussed whether the scope exemption was only limited to the rights in the exploration and evaluation phase ("E&E phase"). Several Group members observed that the scope exemption specifies that it applies to "leases to explore for or use minerals," therefore suggesting that the scope exemption should be extended beyond the E&E phase.

Overall, the Group's discussion raises awareness about the application of IFRS 16 scope exemption for non-regenerative resources. No further action was recommended to the AcSB.

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

IFRS 9 and IAS 37: Credit Enhancement on Trade Receivables

Entities may enter into financial guarantee contracts and insurance contracts (commonly called "credit enhancements") over loan assets or trade accounts receivable. This is done so that when a counterparty defaults on some or all of its obligations, the entity can recover all or some of its losses through the credit enhancement.

In measuring expected credit losses, paragraph B5.5.55 of IFRS 9 *Financial Instruments* requires entities to include the cash flows from the realization of the collateral and other credit enhancements that are:

(a) part of the contractual terms; and

(b) are not recognized separately by the entity.

In December 2015, the IASB's Transition Resource Group for Impairment of Financial Instruments (ITG) discussed what was meant by credit enhancements that are "part of the contractual terms." The ITG observed that credit enhancements included in the measurement of expected credit losses should not be limited to those that are explicitly part of the contractual terms, but rather those that are integral to the contractual terms. All facts and circumstances should be considered in making this judgment. However, the ITG did not address a situation when the financial guarantee is not mentioned in the loan's contractual terms. It also did not address how to account for the credit enhancement if the financial guarantee is determined to be not integral and not otherwise required to be recognized separately.

Fact Pattern

- Entity X is a manufacturer of specialty gear and sells its products to large retailers (i.e., customers).
- Entity X offers credit to its customers so that they have net 90 days to pay for the products sold. Entity X records trade receivables that are accounted for at amortized cost and subject to impairment. The time value of money on these trade receivables is insignificant and, hence, no interest is recorded.
- Entity X enters into a blanket group insurance policy (group insurance policy) with an unrelated third-party to cover its trade receivables. The group insurance policy covers Entity X for up to a maximum exposure of $30 million. Entity X does not need to name each individual trade receivable separately to be covered but rather the third-party insures all trade receivables up to a maximum exposure of $30 million at any point in time.
- Entity X pays a monthly fee to the third-party as premium for the group insurance policy. Premium payments are expensed when incurred.

Issue 1: Is the group insurance policy integral to the contractual terms of each individual trade receivable?

View 1A – Yes, the group insurance policy is integral and should be factored into the measurement of expected credit losses.

Proponents of this view consider that the group insurance policy will compensate Entity X for any losses it suffers on each of the individual trade receivables up to a maximum of $30 million. Also, the individual trade receivables are covered as they are originated because the group insurance policy applies to the whole portfolio at any point in time.

Therefore, the group insurance policy is integral to the contractual terms of each individual trade receivable.

View 1B – No, the group insurance policy is not integral and should not be factored into the measurement of expected credit losses.

Proponents of this view consider that the group insurance policy is not entered into at the same time as each individual trade receivable. Also, the group insurance policy does not name any of the individual trade receivables as assets being insured, nor does each individual trade receivable's contractual terms refer to the insurance contract.

Therefore, the group insurance policy is not integral to the contractual terms of each individual trade receivable.

The Group's Discussion

Group members supported the view that the group insurance policy is not integral to each individual trade receivable and, therefore, should not be factored into the measurement of expected credit losses (View 1B). Their rationale is that Entity X has discretion in deciding whether to enter into the group insurance policy. Therefore, this group insurance policy is a separate risk mitigation strategy. Also, the $30 million coverage is a notional amount that is not specifically linked to specific trade receivables, and therefore, not considered integral to the trade receivable's contractual terms.

One Group member thought that since the group insurance policy would cover in substance at least $30 million of losses, it should be considered in the expected credit loss calculation. However, several Group members noted that the group insurance policy covers incurred losses, whereas the IFRS 9 model considers both whether a loss has occurred and whether a loss might occur in the future. These Group members thought that, the expected credit loss calculation should not consider the existence of the group insurance policy given it is not integral to the contractual terms of the individual trade receivables.

Issue 2: If the group insurance policy is determined not to be integral and not otherwise required to be separately recognized, how should it be accounted for?

View 2A – The group insurance policy should be accounted for as a compensation right by analogy to the guidance for reimbursements in IAS 37 Provisions, Contingent Liabilities and Contingent Assets*.*

Under this view, the group insurance policy likely satisfies the definition of an insurance contract in IFRS 4 *Insurance Contracts.* However, it is excluded from the scope of IFRS 4 because it is a direct insurance contract held by a policyholder. Since the group insurance policy is outside the scope of IFRS 9 and IFRS 4, no specific IFRS Standard applies. As such, the entity should develop its accounting policy in accordance with the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to account for the group insurance policy (i.e., financial guarantee).

Proponents of this view note that since the expected credit loss on the trade receivables has been recognized under IFRS 9, the entity should recognize a compensation right provided it is virtually certain that the compensation will be received if the credit loss is suffered. The compensation right should be accounted for by analogy to IAS 37.

View 2B – The group insurance policy should be accounted for as an indemnification asset by analogy to the guidance for reimbursements in IFRS 3 Business Combinations*.*

This view is similar to View 2A in that the entity should develop its accounting policy in accordance with IAS 8. However, proponents of this view would analogize to IFRS 3's indemnification asset requirement for recognizing the financial guarantee because the recognition threshold for contingent liabilities in IFRS 3 is closer to that of the expected credit loss model in IFRS 9.

Further, IFRS 3 allows an indemnification asset to be recognized and measured on the same basis as the indemnified asset or liability, subject to any contractual limitations on its amount. Measurement is based on management's assessment of whether the indemnification asset is collectible, provided the indemnification asset is not subsequently measured at fair value.

Applying this indemnification asset approach, the guarantor's credit risk becomes a measurement issue rather than a recognition issue. The virtually certain criterion under IAS 37 does not apply to indemnification assets arising from a business combination.

The Group's Discussion

Group members supported that an asset should be recognized for the group insurance policy but expressed diverse views in terms of which IFRS Standard an entity should consider when developing its accounting policy in accordance with IAS 8. One Group member highlighted that if the asset is considered a receivable from the insurer, an expected credit loss would need to be recognized against that receivable for the potential collection risk from the insurer.

Some Group members thought analogizing to IAS 37 (View 2A) in developing an accounting policy may be appropriate but shared several challenges with this approach. For example, one hurdle is overcoming the virtual certainty threshold in IAS 37. One Group member thought that since the entity has a contractual right from the insurer to be reimbursed for losses, virtual certainty is established because the right is enforceable.

Other Group members thought that applying the indemnification asset approach in IFRS 3 (View 2B) can help with overcoming the challenges raised in analogizing to IAS 37. For example, a past event must have taken place for a reimbursement right to be recognized under IAS 37. However, IFRS 3 contemplates recognizing a contingent liability whether or not it is probable an outflow of economic resources will occur. This threshold for recognition of the reimbursement right is closer to that of the expected credit loss model in IFRS 9. Since the entity is insured by the group insurance policy, the contingent liability is like an indemnified liability. As such, an indemnification asset is recognized at the same time the entity recognizes the indemnified item. Under IFRS 3, credit risk associated with the indemnification asset does not affect recognition of the asset but is factored into its measurement. One Group member also thought that the group insurance policy gives the entity certain contractual rights that may have value, and therefore, the indemnification asset approach is more appropriate.

The Group also talked about whether netting the asset against the expected credit loss of the trade receivables is an option. However, several Group members noted that the contract with the insurer is a separate transaction not integral to the trade receivables. Therefore, they thought the amounts should not be offset in the statement of financial position.

Issue 3: If the group insurance policy is determined to be integral and not otherwise required to be separately recognized, how should it be accounted for?

Analysis

- Since the group insurance policy is integral to the trade receivables, it should not be accounted for separately. As such, Entity X needs to consider the effect of the group insurance policy when:
  - measuring the fair value of the trade receivables;
  - estimating the expected cash receipts from the trade receivables; and
  - assessing impairment of the trade receivables.

The Group's Discussion

Since the Group supported the view that the group insurance policy is not integral to each individual trade receivable under Issue 1, the following is a theoretical discussion.

Group members who expressed a view agreed with the analysis. A few Group members noted that if the group insurance policy is integral to the trade receivables, it is collateral that should be considered as part of the loss given default in the expected credit loss calculation. Furthermore, since the expected credit loss may be computed on a portfolio basis, the amount should be lowered by the group insurance policy because it will compensate the entity for the identified cash shortfall. For disclosure purposes, entities would still need to determine at what stage the financial asset is in under the expected credit loss model in IFRS 9 even if a group insurance policy exists.

Overall, the Group discussed these issues to raise awareness about this item. The Group noted that determining whether a credit enhancement is considered integral or not to the contractual terms is dependent on facts and circumstances. No further action was recommended to the AcSB.

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

IFRS 9: Classification of Related Party Loans

IFRS 9 *Financial Instruments* does not distinguish between related and unrelated party transactions. Therefore, related party loan receivables are classified and measured in accordance with IFRS 9, which includes applying the expected credit loss model for impairment when applicable.

Related party loans are typically advanced on terms that are not at arms-length or on an informal basis with unspecified terms. They can also have features that expose the lender to risks that are not consistent with a basic lending arrangement. Applying IFRS 9 to related party loans can be complex.

The Group considered four fact patterns that cover common examples of related party loans and discuss whether they meet the solely payments of principal and interest (SPPI) test in IFRS 9.

Fact Pattern 1

- Parent Entity A provides a loan of CU5 million to Subsidiary C to fund its ongoing business operations. The loan bears zero per cent and CU5 million is repayable on demand of Parent Entity A. Parent Entity A does not intend to demand repayment of the loan for several years and the loan is not considered purchased or originated credit-impaired.
- Subsidiary C has the ability to repay the loan if demanded by Parent A.
- Assume that the loan is scoped into IFRS 9 and does not represent a capital contribution that would be accounted for in accordance with IAS 28 *Investments in Associates and Joint Ventures.*

Issue 1: Does the loan meet the SPPI test?

Analysis

IFRS 9 requires financial assets and financial liabilities to be measured on initial recognition at fair value unless fair value differs from the transaction price.

This loan is an interest-free demand loan. Its initial fair value will equal the transaction price, which is the amount of cash advanced of CU5 million. As the loan is due on demand and no interest is charged, the effective interest rate is zero per cent.

CU5 million represents the repayment of principal amount and interest is nil. Therefore, the loan meets the SPPI test.

The Group's Discussion

Group members agreed with the analysis above, noting that IFRS 9 does not require a loan to earn a rate of interest to meet the SPPI test. Paragraph 4.1.3 of IFRS 9 states, in part, that interest consists of "consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin." IFRS 9 makes no reference to interest being a reasonable amount of compensation.

One Group member questioned whether Parent Entity A's intention not to demand repayment of the loan for several years has a significant bearing in determining the term of the loan. Several Group members thought that determining the length of the loan term does not affect whether the loan could meet the SPPI test for classification purposes, because the nature of the loan's contractual cash flows has not changed. These Group members also noted that in accordance with IFRS 13 *Fair Value Measurement,* a loan that is due on demand is recorded at its face value (i.e., paragraph 47 of IFRS 13). In contrast, if the loan had a specified term rather than being due on demand, the fair value of the loan would be at a discount to the face value of the loan.

Fact Pattern 2

- Parent Entity A provides a loan of CU3 million to Subsidiary D, a real estate investment company.
- Subsidiary D uses the loan to partly fund the purchase of a property worth CU3.5 million. It intends to generate cash flows through rental income.
- The loan is repayable in three years with 5 per cent annual interest. The loan also has a contingent payment clause, which is 30 per cent of the annual appreciation in the property value.

Issue 2 – Does the loan meet the SPPI test?

Analysis

IFRS 9 requires that the loan be assessed in its entirety to determine whether it meets the SPPI test. This loan is linked to an underlying asset performance, which means that the additional contingent payment linked to an appreciation in property value must be considered. Contractual terms can only be ignored if the feature is considered non-genuine or if the potential impact on the contractual flows is considered *de minimis*.

There is no reason to suggest that the contractual term is non-genuine because the property value can increase above its purchase price. The contingent payment could have more than a *de minimis* effect on the contractual cash flows of the loan in each reporting period. For example, even an increase of 10 per cent in the property value would give rise to an additional payment of CU105,000 (i.e., CU350,000 × 30 per cent).

As a result, the loan does not meet the SPPI test because of the additional contingent payment. The contingent feature introduces property price risk, which is inconsistent with a basic lending arrangement.

The Group's Discussion

Group members agreed with the analysis above, noting that the contingent payments (i.e. 30 per cent of the annual appreciation of property value) are inconsistent with payments of principal and interest.

Fact Pattern 3

- Parent Entity A sets up Subsidiary E in January 2017 to purchase a single investment property worth CU2 million. The objective is to generate rental income.
- Subsidiary E was funded by equity from Parent Entity A of CU0.2 million and a bank loan of CU1.8 million, which has a loan-to-value of 90 per cent. The bank loan is repayable on December 31, 2018, with an annual interest rate of 10 per cent and is secured by first charge over the property.
- At December 31, 2018, the property's market value declined to CU1.5 million, resulting in a loan-to-value of 120 per cent. The bank is unwilling to refinance at this loan-to-value rate. Therefore, Subsidiary E repays the bank loan using a loan obtained from Parent Entity A.
- The loan from Parent Entity A of CU1.8 million is repayable on December 31, 2020 with an annual interest rate of 20 per cent and is secured by first charge over the property. Subsidiary E continues to earn enough rental income to cover interest payments but has no other assets or sources of income. The annual interest rate of 20 per cent is a market rate for loans with similar terms with specialist property lenders.

Issue 3: Does the loan from Parent Entity A to Subsidiary E meet the SPPI test?

View 3A – Yes, the loan meets the SPPI test.

Proponents of this view note there is nothing to indicate that the loan is not a financing arrangement to generate principal and interest since the interest rate is at market. On this basis, the loan would meet the SPPI test.

View 3B – No, the loan does not meet the SPPI test.

Proponents of this view note that regardless of how this loan is structured, in substance this is a non-recourse loan because Subsidiary E only holds one asset that can be used to repay the loan. Although Subsidiary E can make the interest payments using rental income, the principal repayment is limited because the value of the property is not enough to repay the loan.

Parent Entity A is exposed to a property price risk that seems more than just the basic lending risks (i.e., time value of money and credit risk). This exposure suggests that the loan is like an indirect investment in the underlying property. On this basis, the loan would not meet the SPPI test.

The Group's Discussion

Most Group members supported View 3B that the loan does not meet the SPPI test. These Group members thought a loan that exceeds the value of property that collateralizes it by 20 per cent may not be representative of an ordinary lending arrangement and that there are other elements to the arrangement.

One Group member questioned whether this fact pattern contains a measurement issue rather than a classification issue. This Group member thought that the high loan-to-value ratio would indicate there is a risk of impairment on the loan. However, the nature of the loan's contractual cash flows in the fact pattern remain to be principal and interest. Therefore, this Group member preferred View 3A.

The Group also discussed the 120 per cent loan-to-value implication on initial measurement of the loan. One Group member commented that the inherent interest rate could be higher than 20 per cent when considering the initial discount from the loan-to-value ratio. Elements of this loan could also be considered a contribution from the parent to the subsidiary.

Fact Pattern 4

- Same as Fact Pattern 3 except that on December 31, 2018, the property's market value increased to CU2.2 million. As such, the loan-to-value changed to 82 per cent. Subsidiary E chooses to repay the bank loan by obtaining funding from Parent Entity A instead.
- Parent Entity A provides a loan for CU1.8 million repayable on December 31, 2020, with an interest rate of 7 per cent. The interest rate is at market rate for a loan with similar terms.

Issue 4: Does the loan from Parent Entity A to Subsidiary E meet the SPPI test?

View 4A – Yes, the loan meets the SPPI test.

Proponents of this view note that, in substance, this is a limited recourse loan because Subsidiary E holds one asset that can be used to repay the loan. However, the principal repayment would not seem to be limited in a manner that is inconsistent with a basic lending arrangement because the property value is enough to generate cash flows to repay the loan. On this basis, the loan meets the SPPI test.

View 4B – No, the loan does not meet the SPPI test.

This view is consistent with View 3B in that the loan-to-value should not be considered. On this basis, the loan does not meet the SPPI test.

The Group's Discussion

Most Group members supported the view that the loan likely meets the SPPI test (View 4A), noting that the 82 per cent loan-to-value indicates the property value is probably high enough to generate cash flows to repay the loan. One Group member commented that given the facts and circumstances of Fact Patterns 3 and 4 are different at the inception of the related party loan, the outcome of the SPPI test is different. Therefore, it is important to consider the specifics of each fact pattern because the conclusions reached may vary based on different circumstances.

The Group commented that there is not a bright-line test to determine the point at which the loan-to-value ratio may impact the SPPI test and that professional judgement is required. Furthermore, the Group thought that the value of the underlying asset should not be the sole indicator to evaluate whether SPPI test is met and that specific facts and circumstances related to the asset should be considered.

One Group member commented that Fact Patterns 3 and 4 were limited to non-recourse loans and not contractually linked instruments (e.g., entity with a waterfall structure) that are more commonly seen in the financial service industry. This Group member noted that guidance in IFRS 9 for contractually linked instruments and non-recourse loans is different, and therefore, it is important to consider the entity's structure holistically to determine which guidance to apply.

The Group's discussion raises awareness about factors to consider in determining whether a related party loan would meet the SPPI test. No further action was recommended to the AcSB.

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

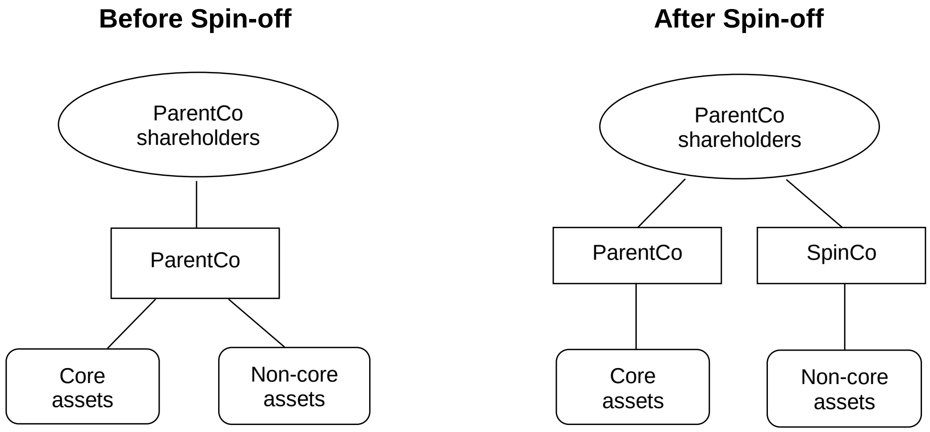
Spin-off Transaction

IFRIC 17 *Distributions of Non-cash Assets to Owners* addresses a situation when an entity distributes assets other than cash as dividends to its owners acting in their capacity as owners. In this situation, an entity measures the dividend payable at the fair value of the assets to be distributed. On settlement, any difference between the carrying value of the assets distributed and the carrying amount of the dividend payable is recognized in profit or loss.

Paragraph 5 of IFRIC 17 states, in part, that "[t]his Interpretations does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution."

Fact Pattern

- An entity ("ParentCo") decides to spin off one of its non-core assets (e.g., a mineral property) to its shareholders. The entity's shares are listed on a stock exchange and it has many shareholders. There is no shareholder or group of shareholders that can exercise control over the entity.
- The asset to be spun-off does not constitute a business. Prior to the spin-off, the entity did not prepare separate financial information for the asset other than to capitalize certain expenditures that were incurred in connection with its acquisition and development.
- To conduct the spin-off, the entity will create a new subsidiary ("SpinCo") and then concurrently:
    - assign the asset to that subsidiary in return for shares of SpinCo;
    - distribute the shares of SpinCo to its shareholders; and
    - apply to list the shares of the SpinCo on a stock exchange.



Issue 1: Is this spin-off transaction within the scope of IFRIC 17?

Analysis

Paragraph 6 of IFRIC 17 refers to paragraph B2 of IFRS 3 *Business Combinations*, which states that "[a] group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities."

In this fact pattern, no group of individual shareholders would have control over SpinCo or ParentCo because there is no contractual arrangement among them. Since the asset is not controlled by the same party or parties before and after the spin-off transaction, this transaction is within the scope of IFRIC 17.

The Group's Discussion

Group members agreed with the analysis and noted that paragraphs 13 and 14 of the Basis for Conclusions on IFRIC 17 also supports this analysis.

Issue 2: Assume IFRIC 17 applies to the spin-off transaction, does IFRIC 17 also apply to the recognition and measurement of the asset in SpinCo?

View 2A – No.

Under this view, IFRIC 17 only applies to ParentCo making the non-cash distribution (i.e., accounting for the dividend payable and the asset distributed).

The substance of the spin-off transaction is that a component of ParentCo was carved out and held in a separate legal entity (i.e., SpinCo). However, the shareholders have the same ownership interest in the asset before and after the transaction. Therefore, accounting for the asset should reflect the shareholders' continuity of interest.

For reporting issuers with shares listed on Canadian stock exchanges, securities regulation may require carve-out financial statements in filings made in connection with certain spin-off transactions. Carve-out financial statements would have an appropriate allocation of historical assets, liabilities and expenses of ParentCo that are relevant to SpinCo. SpinCo's financial statements would reflect the spin-off transaction as a capital transaction and include historical financial information based on the carve-out financial statements.

View 2B – Yes.

Under this view, since IFRIC 17 applies to the spin-off transaction, SpinCo should apply the requirements in accounting for the asset as well.

Carve-out financial statements and reflecting shareholders' continuity of interest in an asset are typically used when common control exists. However, the asset transferred is not ultimately controlled by the same party or parties before and after the transaction. In addition, carve-out financial statements may not be relevant and indicative of SpinCo's future financial performance.

As such, the accounting for SpinCo should mirror the accounting of ParentCo. SpinCo should recognize the asset at fair value with a corresponding entry to equity.

View 2C – Similar to View 2A, except that using carve-out financial statements is not appropriate.

Proponents of this view agree with the reasons in View 2B that using carve-out financial statements is not appropriate. However, there was no negotiation between arm's length parties and no change in relative ownership interests before and after the transaction.

As such, SpinCo should recognize the asset at its existing carrying value prior to the spin-off with a corresponding entry to equity.

View 2D – There is an accounting policy choice.

Since there is no specific guidance in IFRS Standards on this issue, an entity can establish an accounting policy and apply it consistently to all similar transactions.

The Group's Discussion

Group members thought that SpinCo should look to IFRS 2 *Share-based Payment* and measure the asset at fair value. They thought that:

a) IFRS 2 applies to this transaction because SpinCo acquired the asset through the issuance of its shares; and

b) the shares would generally be measured by reference to the fair value of the asset received in accordance with IFRS 2.

Several Group members highlighted other things to consider. For example, one Group member thought it important for entities consider if the spun-off asset constitutes a business as it is possible that the newly created entity could acquire processes surrounding the mineral property.

A few Group members observed seeing some diversity in practice in which the asset in SpinCo is measured at ParentCo's carrying value of the asset. These Group members thought that this diversity may stem from the application of paragraph 4 of IFRS 2 as it may be viewed to scope out spin-off transactions. Another challenge entities encounter is coming up with a fair value measurement of an early stage mineral property, and therefore, ParentCo's carrying value of the asset is used. However, a Group member noted that the fair value of the asset would need to be determined because ParentCo would measure the dividend payable to its shareholders (i.e., shares of SpinCo) at the fair value of the asset distributed under IFRIC 17. Overall, Group members acknowledged recognizing the asset at fair value provides transparent and meaningful results to users.

The Group also discussed compliance with securities regulation and noted that presentation of historical information is a separate issue from determining the accounting for SpinCo. If SpinCo needs to produce historical information about the asset to fulfill securities law requirements, the entity could prepare financial statements on a carve-out basis. Representatives from the Canadian Securities Administrators (CSA) agreed that filing requirements of securities regulation do not drive the accounting for SpinCo. One of the CSA representatives emphasized it is important that useful information be provided to investors, whether through the predecessor entity or some other means of carve-out historical information, to convey what activity has occurred to develop the mineral property. Furthermore, since management plans to list SpinCo shares on an exchange following the transaction, investors will need to have a complete picture of the mineral property's history.

The Group's discussion raises awareness about the accounting for spin-off transactions. No further action was recommended to the AcSB.

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

Cryptocurrencies – Other Considerations

The Group discussed various cryptocurrency related topics at its January 2018, June 2018 and October 2018 meetings. The topics include investments in decentralized digital currencies (also called "cryptocurrencies"), mining or validation activities, and employee benefits.

At this meeting, the Group discussed two fact patterns involving:

- an entity that receives cryptocurrencies from the sale of goods or services and then subsequently monetizes them; and
- a commodity broker-trader who trades in cryptocurrencies and measures them at fair value less costs to sell (FVLCS).

Fact Pattern 1

A retailer accepts cryptocurrency as a form of payment for goods (i.e., widgets) it sells in the ordinary course of business. To minimize exposure to changes in the value of the cryptocurrency, the retailer monetizes the cryptocurrency collected for fiat currency shortly following receipt.

Issue 1: Should the cryptocurrency collected be accounted for under the scope of IAS 2* Inventories *or IAS 38* Intangible Assets*?

Analysis

The cryptocurrency is not purchased and held for resale nor is it an asset or material used in the production process. Rather, the cryptocurrency is collected as a form of payment for the retailer's sale of widgets in the ordinary course of business. As a result, the cryptocurrency does not form part of the retailer's inventory as it would not meet the definition in paragraph 6 of IAS 2.

The retailer is not considered a commodity broker-trader because, in the fact pattern, it monetizes cryptocurrency to minimize exposure to changes in value. A commodity broker-trader's inventories are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-trader's margin.

In September 2018, the IFRS Interpretations Committee discussed how an entity applies existing IFRS Standards to account for cryptocurrency holdings. In the IFRIC Staff Paper (agenda paper AP4A), paragraphs 70 and 71 outline the staff's view. If an entity holds cryptocurrencies for sale in the ordinary course of business, it would meet the definition of inventories. If an entity does not apply IAS 2, it applies IAS 38 because cryptocurrencies meet the definition of an intangible asset. Most Committee members agreed with the staff's conclusions.

Therefore, the cryptocurrency the retailer collected is not within the scope of IAS 2 but within the scope of IAS 38.

The Group's Discussion

Group members who expressed a view thought that the analysis was reasonable. A few Group members emphasized the importance of considering the business model of the entity. They thought that if the cryptocurrency is being held for a long period, such behaviour may indicate the entity has a speculation strategy to realize a profit.

A question was raised whether the cryptocurrency would be measured at the fair value of the goods given up. A few Group members thought this question could arise depending on how the retailer priced the good (e.g., whether the goods were priced in fiat currency but settled in units of the cryptocurrency of equal value or whether the goods were priced in cryptocurrency). Group members noted that the non-cash consideration guidance in IFRS 15 *Revenue from Contracts with Customers* would apply given the cryptocurrency is not a financial asset.

Fact Pattern 2A

- Entity A buys and sells cryptocurrency for others or on its own account. The cryptocurrency is principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin, and therefore, is within the scope of IAS 2
- There is a liquid market for the specific cryptocurrencies that Entity A trades and, as such, the cryptocurrencies are readily convertible to cash. Entity A measures its cryptocurrency at FVLCS in accordance with paragraph 3(b) of IAS 2.
- On January 1, 2018, Entity A purchased 100 units of cryptocurrency at $1,000/unit for a total cost of $100,000.
- On January 15, 2018, the entity enters into a sales agreement with a customer to deliver 100 units of that same cryptocurrency (i.e., non-financial item) on January 31, 2018 for $1,100/unit. The fair value of the contract was nil at the date it was entered into as the contract was at the money.
- On January 31, 2018, Entity A delivers the cryptocurrency to the customer and collects $110,000 cash. On this date and immediately prior to sale, the fair value of the cryptocurrency was $1,050/unit.

- For simplicity, all other costs, such as fees paid to validate transactions and any other costs to purchase or dispose of the cryptocurrencies in question, are assumed to be nil.
- Entity A assesses the sales agreement and determines it meets the own use scope exception in paragraph 2.4 of IFRS 9. The sales agreement was entered into for delivering the cryptocurrency in accordance with Entity A's expected sale requirements. Entity A does not have a history of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments. Entity A does not make the designation permitted in IFRS 9 to measure the sales agreement at fair value through profit and loss.

Issue 2A: Given this sales agreement meets the own use scope exception in IFRS 9, how should the commodity broker-trader record and present the sale of the cryptocurrency on the statement of comprehensive income?

Analysis

Entity A is not required to apply IFRS 9 because the sales agreement meets the own use scope exception. Appendix A of IFRS 15 defines revenue as "income arising in the course of an entity's ordinary activities." In this fact pattern, the purchase and sale of cryptocurrency are activities within the ordinary course of Entity A's operations and the sale is with a customer. Therefore, the commodity broker-trader applies IFRS 15 to the sale of its cryptocurrency inventory.

Paragraph 82 of IAS 1 *Presentation of Financial Statements* requires that the statement of comprehensive income include a separate line for revenue. Paragraph 113 of IFRS 15 further requires separate presentation or disclosure of revenue from contracts with customers.

Based on paragraph 3(b) of IAS 2, Entity A is only excluded from applying IAS 2 in measuring its inventories. This means that the non-measurement requirements in IAS 2 still apply, such as paragraph 34 of IAS 2 that states "[w]hen inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised."

The following reflects the journal entries that Entity A should record for the sales agreement:

Activity	Journal Entry
Purchase of cryptocurrency on Jan. 1	Dr: Cryptocurrency inventory $100,000 Cr: Cash $100,000
Change in FVLCS of cryptocurrency on Jan. 15	Dr: Cryptocurrency inventory $10,000 Cr: Remeasurement gains/losses $10,000
Change in FVLCS of cryptocurrency prior to sale	Dr: Remeasurement gains/losses $5,000 Cr: Cryptocurrency inventory $5,000
Sale and transfer of cryptocurrency on Jan. 31	Dr: Cash $110,000 Cr: Revenue $110,000 Dr: Expense for cryptocurrency inventory sold including realized changes in FVLCS $105,000 Cr: Cryptocurrency inventory $105,000

Although different presentation approaches are possible in the statement of comprehensive income, the composition of the line items presented should be transparent and the line-item descriptions should faithfully represent the composition. Entities should also consider disaggregating actual cost of sales from realized and unrealized cryptocurrency inventory remeasurement gains and losses. If an entity presents a gross margin subtotal, entities should ensure it is transparent as to whether that subtotal includes or excludes unrealized cryptocurrency inventory remeasurement gains and losses.

The Group's Discussion

Some Group members commented that Fact Pattern 2A is not commonly observed in today's market because cryptocurrencies are typically traded at the spot rate instead of settling through forward contracts. However, one Group member noted that it is possible an exchange traded fund may be created for cryptocurrencies in the future, in which case forward contracts may become more common.

A few Group members also indicated not seeing commodity broker-traders apply the own use scope exception. A question was raised as to whether such scope exception is available to commodity broker-traders because their intent is to acquire and sell to generate profit from fluctuations in price. The own use scope exception is for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item. The scope exception's objective does not seem to describe broker-traders, who are neither consumers nor producers of the items they trade.

In discussing the presentation approaches in the statement of comprehensive income, several Group members noted that the factors to consider are similar to the discussion in June 2018 on the cannabis accounting topic.[2] Given the current guidance in IAS 1, different presentation approaches could exist. However, consistent with the above analysis, entities should consider their financial statement users' needs and provide information that is sufficiently disaggregated and transparent so that the users understand what is, or is not, included in the financial statement line items presented.

Fact Pattern 2B

- The facts are the same as Fact Pattern 2A, except that Entity A concludes that the sales agreement does not meet the own use scope exception in paragraph 2.4 of IFRS 9. The reason is that Entity A has a history of settling similar contracts on a net cash basis.
- The sales agreement is accounted for as a derivative within the scope of IFRS 9. Entity A does not designate the derivative as part of a hedging relationship for accounting purposes.

Issue 2B: Given this sales agreement does not meet the own use scope exception in IFRS 9, how should the commodity broker-trader record and present the sale of the cryptocurrency on the statement of comprehensive income?

Analysis

The IFRS Interpretations Committee discussed a fact pattern that is consistent with Fact Pattern 2B at its November 2018 meeting.[3] The tentative agenda decision indicated that the request assumes that the entity has an accounting policy of recognizing revenue on a gross basis for such contracts.

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[2] In June 2018, the Group discussed how changes in the fair value less costs to sell of cannabis plants should be presented in the statement of comprehensive income (i.e., IAS 2 and IAS 41: Cannabis Accounting – Presentation).

[3] Refer to the IFRS Interpretations Committee's tentative agenda decision, "Physical settlement of contracts to buy or sell a non-financial item (IFRS 9 *Financial Instruments*)."

The Committee only addressed the submitter's question, which is whether the entity is permitted or required to make an additional journal entry that would:

- reverse the accumulated gain or loss previously recognized in profit or loss on the derivative (even though the fair value of the derivative is unchanged); and
- recognize a corresponding adjustment to either revenue (in the case of the sale contract) or inventory (in the case of the purchase contract).

The Committee concluded that IFRS 9 neither permits nor requires an entity to make the additional journal entry described in the request as it would effectively negate the requirement in IFRS 9 to account for the contract as a derivative.

However, a secondary question is whether the sales agreement can be recognized either on a gross basis (i.e., revenue and cost of sales) or net basis (i.e., net profit or loss in a similar manner to a trading transaction) upon physical settlement in delivering the cryptocurrency.

Based on the assumption in the tentative agenda decision, it seems to suggest there is an accounting policy of recognizing revenue on a gross basis or on a net basis. However, the Committee did not specifically address whether the sale would be recognized as revenue under IFRS 15 or other revenue under a gross basis.

The journal entries for physical settlement of the sales agreement on either gross and net presentation would be as follows:

Activity	**Journal Entries** (same for gross and net presentation basis except as noted below)	
Purchase of cryptocurrency on Jan. 1	Dr: Cryptocurrency inventory $100,000 Cr: Cash $100,000	
Change in FVLCS of cryptocurrency on Jan. 15	Dr: Cryptocurrency inventory $10,000 Cr: Remeasurement gains/losses $10,000	
Change in fair value of contract prior to sale	Dr: Derivative asset/liability $5,000 Cr: Derivative gains/losses $5,000	
Change in FVLCS of cryptocurrency prior to sale	Dr: Remeasurement gains/losses $5,000 Cr: Cryptocurrency inventory $5,000	
	Gross Presentation Basis	**Net Presentation Basis**
Physical settlement of sales contract and transfer of cryptocurrency on Jan. 31	Dr: Cash $110,000 Cr: Derivative asset/ liability $5,000 Cr: Revenue $105,000 Dr: Expense for cryptocurrency inventory sold including realized changes in FVLCS $105,000 Cr: Cryptocurrency inventory $105,000	Dr: Cash $110,000 Cr: Derivative asset/ liability $5,000 Cr: Cryptocurrency inventory $105,000

The comments on the presentation format under the analysis of Issue 2A would also apply to Issue 2B. In addition, the presentation of the derivative gain or loss in the statement of comprehensive income would follow Entity A's policy for the presentation of gains and losses on derivatives not designated as hedges for accounting purposes.

The Group's Discussion

One Group member considered the substance of a commodity broker-trader's activity, which is to make profit on commission by buying or selling for others or on its own account. In this case, recording the sale of the cryptocurrency on a gross basis, with cost of goods sold, does not seem consistent with the commodity broker-trader's activity. Alternatively, the commodity broker-trader could present the transaction on a net basis that would show the commission or profit from acquiring and selling the cryptocurrency. A few Group members thought commodity broker-traders would likely present the transaction using a net basis given the nature of their activities.

Several Group members were unclear whether the IFRS Interpretations Committee's tentative agenda decision is intended to apply to a situation involving a commodity broker-trader. The Group recommended that the AcSB staff seek clarity on whether the scope of the tentative agenda decision is intended to encompass the activities of commodity broker-traders.

Overall, the Group's discussion raises awareness of other scenarios that may involve cryptocurrencies. Except for the AcSB staff seeking clarity on the intent of the IFRS Interpretations Committee's tentative agenda decision, no further action was recommended to the AcSB.

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

IFRS 3: Definition of a Business

In October 2018, the IASB issued amendments to IFRS 3 *Business Combinations* that clarify the definition of a business. The objective of the amendments is to assist entities in determining whether a transaction should be accounted for as a business combination or an asset acquisition. The amendments were incorporated into Part I of the CPA Canada Handbook – Accounting on December 1, 2018.

Paragraph 64P of IFRS 3 states:

> *Definition of a Business*, issued in October 2018, added paragraphs B7A–B7C, B8A and B12A–B12D, amended the definition of the term 'business' in Appendix A, amended paragraphs 3, B7–B9, B11 and B12 and deleted paragraph B10. An entity shall apply these amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period. Earlier application of these amendments is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

The Group considered a fact pattern and discussed when the amendments can be applied early.

Fact Pattern

- Entity A made three acquisitions during 2018. The acquisitions occurred on February 1, November 1 and December 1. Prior to the amendments to IFRS 3, these acquisitions would be accounted for as business combinations.

- If the transactions are assessed under the amended definition of a business, then all three acquisitions would be accounted for as asset acquisitions.
- Entity A has a December 31 year-end and would like to early apply the amendments to IFRS 3 in fiscal 2018.

Issue 1: Assume Entity A does not have quarterly reporting requirements. To which acquisition could Entity A apply the amended definition of a business?

View 1A – Only to the December acquisition.

The amendments are to be applied prospectively and can only be applied after they have been incorporated into Part I of the CPA Canada Handbook – Accounting. Therefore, since Entity A is early adopting the amendments to IFRS 3, the February and November acquisitions would be accounted for as business combinations and the December acquisition would be accounted for as an asset acquisition.

View 1B – To all three acquisitions.

The amendments are to be applied prospectively at the beginning of the first annual reporting period adopted. Since Entity A is early adopting the amendments for fiscal 2018, the amended definition of a business would be applied to all the acquisitions during the year.

View 1C – The entity has a policy choice and could apply View 1A or 1B.

Paragraph 64P of IFRS 3 does not specify whether early adopters apply the amended definition of a business from the beginning of the fiscal year in which the amendments were adopted. Therefore, a policy choice exists.

View 1D – None of the acquisitions.

Since the amendments were issued after the beginning of the fiscal year, Entity A cannot early adopt them until January 1, 2019.

The Group's Discussion

In the fact pattern described, Group members supported applying the amended definition of a business to all three acquisitions if the amendments were early adopted (View 1B). Their rationale was that an entity should apply the same accounting policy consistently for similar transactions based on guidance in paragraph 13 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* As a result, Group members thought that the views of applying the amendments to only the December acquisition or that an accounting policy choice existed are not reasonable (View 1A or 1C). The view of applying the amendments to none of the acquisitions (View 1D) was considered reasonable because Entity A would still be applying a consistent accounting policy (i.e., existing definition of a business) throughout the year. However, Group members thought there was nothing within IFRS Standards that would preclude Entity A from early adopting the amendments in fiscal 2018 from the beginning of the fiscal year.

To be considered Canadian GAAP, it is important to note that new IFRS Standards or amendments must be endorsed by the Accounting Standards Board and incorporated into Part I of the CPA Canada Handbook – Accounting. One Group member commented that the amendments to IFRS 3 are available for early adoption as long as they are incorporated into Canadian GAAP by the time the financial statements are authorized for issue (i.e., using the date of authorization for issue under IAS 10 *Events After the Reporting Date)*.

Another Group member observed that the transition requirements in U.S. GAAP, Accounting Standards Update (ASU) 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* indicate that early application of the amendments is allowed only when the transaction has not been reported in financial statements that have been issued or made available for issuance.[4] Considering this point, this Group member also supported View 1B.

Issue 2: Assume Entity A has quarterly reporting requirements. To which acquisitions could Entity A apply the amended definition of a business?

View 2A – Only to the December acquisition.

This view is similar to View 1A.

View 2B – To the November and December acquisitions.

This view considers that the transitional provision does not specify annual periods when referring to early application. Entity A could also adopt the amendments at the beginning of its fourth quarter interim period (i.e., starting October 1, 2018). The February acquisition would be accounted for as a business combination and the November and December acquisitions would be asset acquisitions.

View 2C – To all three acquisitions.

This view considers that the amendments are to be applied prospectively at the beginning of the first annual period adopted. Since Entity A is early adopting for its December 2018 year-end, the amended definition of a business would apply to all the acquisitions during the year, and therefore, the acquisitions would be accounted for as asset acquisitions. Entity A would restate its previously issued quarterly financial statements.

View 2D – The entity has a policy choice and could apply View 2A, 2B or 2C.

This view is similar to View 1C in that paragraph 64P of IFRS 3 does not specify whether early adopters apply the amendments from the beginning of an annual or interim reporting period. Therefore, a policy choice exists.

View 2E – None of the acquisitions.

This view is similar to View 1D.

[4] Refer to pg. 4 of ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*.

The Group's Discussion

Most Group members supported applying the amended definition of a business to all three acquisitions if the amendments were early adopted, even if quarterly reporting requirements exist (View 2C). One Group member noted that the guidance in paragraphs 43-45 of IAS 34 *Interim Financial Reporting* would not allow for two different accounting policies to be applied to a particular class of transactions within a single financial year. Other Group members also thought that View 2C would produce better results for investors because there would not be two different definitions of a business applied to similar transactions in the same annual financial statements. Overall, Group members thought Views 2A, 2B and 2D cannot be supported under existing IFRS Standards. Similar to Issue 1, Group members thought that there was nothing that would preclude Entity A from early adopting the amendments in fiscal 2018 from the beginning of the fiscal year.

One Group member expressed a different view by referring to U.S. GAAP (i.e., ASU 2017-01). In this fact pattern, since interim financial statements have been issued, ASU 2017-01 would prohibit the amended definition of a business to be applied to previously reported acquisitions.

In addition to Issue 2, the topic of filing requirements from a securities regulations perspective also came up during the Group's discussion. The Group briefly discussed the implications of an entity early applying the amended definition of a business to previously filed quarterly interim financial information.[5] Although materiality is a factor to consider when deciding whether restating and refiling is needed, a representative from the Canadian Securities Administrators (CSA) encouraged reporting issuers to be conservative in making that judgment call.

The Group talked about a situation in which an entity makes various acquisitions in Q1, Q2 and Q3 of 2018, and the entity decides to adopt the amendments in Q4 of 2018. The question raised was whether an entity would have to consider refiling restated financial information for Q1, Q2 and Q3 of 2018, or whether the entity may refile only the restated Q3-2018 interim financial information with detail showing the impact of the amendments to each quarter. That is, the restated Q3-2018 interim financial information would include the cumulative effect of applying the amended definition of a business as if it had been applied from the beginning of the fiscal year. If this situation were to arise, the CSA representatives encouraged reporting issuers to contact their local securities regulator to discuss the extent of disclosure needed based on the entity's facts and circumstances.

The Group also briefly discussed another issue, which is what the words "earlier application of these amendments is permitted" in the transition provision imply (i.e., paragraph 64P of IFRS 3). For example, do those words cover only the annual reporting period between the IASB's issuance date of the amendments and the mandatory effective date, or do those words extend back to prior periods? Mixed views were expressed, and therefore, the Group recommended that the AcSB staff

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5 In Canada, each province and territory has its own securities regulator that is responsible for the administration and enforcement of the jurisdictional Securities Act, which includes filing of disclosure documents (i.e., financial statements prospectuses, etc.) by reporting issuers. The requirements for filings and necessary conditions for refiling are within the domain of the securities regulators. After the meeting, representatives from the Canadian Securities Administrators indicated that reporting issuers should contact their jurisdictional securities regulators for refiling questions related to early adopting the amendments to IFRS 3.

connect with the IASB staff to obtain insight as to the intent of this part of the transition provision and report back at a future meeting.

Overall, the Group's discussion raises awareness about whether the amendments to IFRS 3 can be early adopted by entities for annual reporting periods beginning on or after January 1, 2018. Except for the AcSB staff connecting with the IASB staff as noted above, no further action was recommended to the AcSB.

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

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

IFRS 16 and IAS 38: Cloud Computing Arrangements

At its January 2018 meeting, the Group discussed the accounting for cloud computing arrangements, specifically an arrangement in which the customer pays fees to the supplier to access the supplier's hardware and application software. At the June 2018 meeting, the AcSB staff reported that the AcSB considered the Group's recommendation and submitted the issue to the IFRS Interpretations Committee for consideration.

The IFRS Interpretations Committee discussed the issue at its September and November 2018 meetings and published a tentative agenda decision to clarify the accounting for such an arrangement. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period if they have any concerns.

IAS 2 and IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation and Presentation

At its June 2018 meeting, the Group recommended that two cannabis accounting issues be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee.[6] The AcSB discussed the issues at its July 2018 meeting and directed staff to conduct research on whether entities in other jurisdictions are encountering similar issues in applying IAS 41 *Agriculture* to account for biological assets.

The AcSB considered the research in December 2018 and decided to submit one of the issues after considering IFRS Interpretations Committee's agenda criteria. The submission will focus on clarifying whether IAS 41 intends for costs incurred for the development of biological assets measured at fair value less costs to sell to be capitalized or expensed.

The AcSB also determined that the presentation issue would not meet the Committee's agenda criteria because it is not sufficiently narrow in scope and cannot be resolved efficiently within the confines of IFRS Standards. The IASB currently has a project that focuses on improving the structure and content of primary financial statements. The AcSB will monitor this project for an opportunity to bring forward this presentation issue.

[6] At its June 2018 meeting, the Group recommended the following two topics for the AcSB to consider:
- IAS 41: Cannabis Accounting – Costs Incurred Related to Biological Transformation
- IAS 2 and IAS 41: Cannabis Accounting – Presentation

IFRS 16 and IAS 16: Accounting for Asset Retirement Obligations

At its October 2018 meeting, the Group recommended that the issue be discussed with the AcSB to determine whether it should be referred to the IASB or IFRS Interpretations Committee.

At the January 2019 meeting, the AcSB staff reported that the AcSB discussed the issue and agreed that the standards are unclear on whether the costs to remove an immovable equipment from the leased land should be part of the right-of-use asset under IFRS 16 *Leases* or an item of property, plant and equipment under IAS 16 *Property, Plant and Equipment*. The AcSB decided to explore options with the IASB to clarify the issue for stakeholders.

The IASB staff was invited to the Group's January 2019 meeting to share insights into the IASB's thinking on the interaction between IFRS 16 and IAS 16. The IASB staff noted that the IASB developed the requirements in paragraph 24(d) of IFRS 16 for leased assets to mirror those in paragraph 16(c) of IAS 16 for owned assets. The rationale was that an entity can incur costs in dismantling and removing a leased asset as it can in dismantling and removing an owned asset. Depending on whether such costs are incurred in relation to a leased asset or owned asset, the IASB decided they should be part of the cost of the right-of-use asset or the item of property, plant and equipment, respectively. In developing IFRS 16, the IASB did not change IAS 16 in this respect and so it did not anticipate any change in accounting for the costs of dismantling and removing an item of property, plant and equipment.

OTHER MATTERS

Sale of Output by a Joint Operator

In November 2018, the IFRS Interpretations Committee published a tentative agenda decision on how a joint operator accounts for output arising from a joint operation. The fact pattern may be of interest to the extractive industries in Canada. The IFRS Interpretations Committee concluded for the fact pattern that the joint operator recognizes revenue for the transfer of output to its customers and does not recognize revenue for the output to which it is entitled but has not received from the joint operation and sold. Stakeholders were encouraged to write to the IFRS Interpretations Committee before the end of the comment period if they have any concerns.

IBOR Reform

In December 2018, the IASB decided to move from its active research agenda to its standard-setting program the project on the effects on financial reporting of the interbank offered rate (IBOR) reform. The project will prioritize the analysis of accounting issues affecting financial reporting leading up to the IBOR reform. Then the project will focus on issues that affect financial reporting when the IBOR reform is enacted. Stakeholders are encouraged to stay abreast of developments on this project.

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

PRIVATE SESSION

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

IASB and IFRS Interpretations Committee – Documents for Comments

At its January 2019 meeting, the Group provided input on the following documents to assist in the development of the AcSB's response letters:

- IASB's December 2018 Exposure Draft, "Onerous Contracts – Cost of Fulfilling a Contract (Proposed amendments to IAS 37)"; and
- IFRS Interpretations Committee's Tentative Agenda Decision, "Customer's right to access the supplier's software hosted on the cloud (IAS 38 *Intangible Assets*)."