

IFRS Discussion Group

Report on the Public Meeting

November 25, 2009

(These notes are a summary only of the discussions held. For a full understanding of the discussions and views expressed the recording of the meeting available [here](#) should be viewed.)

Criteria for Issues Eligible for Consideration by the IDG

The group was reminded that the purpose of the IFRS Discussion Group (IDG) is to assist the AcSB in identifying issues arising from the application of IFRSs in Canada. Through discussions in this public forum, the IDG will evaluate whether there is diversity in practice in Canada and whether issues raised meet the criteria for consideration by the International Financial Reporting Interpretations Committee (IFRIC). IDG members were advised that they are not expected to seek a consensus on the treatment of an issue, only to determine if there is an issue that should be recommended to the AcSB for consideration by the IFRIC. In addition to issues raised by the application of IFRSs in Canada, the IDG may be asked to discuss issues that other national standard setters, or IFRIC staff, have identified for which an evaluation is being made as to whether the issue is widespread. The discussions of the IDG do not constitute official pronouncements or authoritative guidance.

Canadian stakeholders are encouraged to submit issues for discussion in IDG meetings, attend meetings in person, or via the internet, or listen to an archived copy of the meeting discussions.

IFRS 1: Meaning of “Presented”

IFRS 1 *First-time Adoption of International Financial Reporting Standards* includes requirements to provide reconciliations to explain how a company’s transition from previous GAAP to IFRSs affected its reported financial statements. The issue raised was what would qualify as previously “presented” financial statements.

IDG members noted that there might be limited usefulness in providing the required reconciliations when a company’s previous financial statements had limited distribution. There was a diversity of views as to when the reconciliations would be required. AcSB staff was asked to undertake additional research to determine what had happened in other jurisdictions, on and after transition to IFRSs.

IFRS 1 and IAS 11: Capitalized Actuarial Gains and Losses on Change in Accounting Policy for Defined Benefit Plan Obligations

When an entity recognizes changes to its obligations under a defined benefit plan using a method similar to the “corridor” approach under IAS 19 *Employee Benefits*, a portion of the actuarial gains and losses may not be recognized in profit and loss immediately, but might instead be allocated to the cost of self-developed assets such as inventory or plant and equipment. However, in accordance with IFRSs, an entity might change its accounting policy to recognize actuarial gains and losses immediately. The first question asked was whether the IFRIC should consider a clarification as to whether restatement of assets containing capitalized actuarial gains and losses

is required when such a change in accounting policy is made under IFRSs for defined benefit plan obligations. Many members of the IDG indicated that there seems to be sufficient guidance in IFRSs to reach a reasonable conclusion on this issue. Therefore, IDG members recommended that no request be made to the IFRIC on this issue.

It was noted, however, that when the option to write off actuarial gains and losses is utilized on transition to IFRSs, in accordance with IFRS 1, it would be helpful if the IASB considered extending the option to provide relief from the requirement, implied by required retrospective restatement, to restate assets and liabilities that include capitalized gains and losses.

A second question considered the effect upon transition of the write-off of the cumulative actuarial gains and losses on long-term contracts and the determination of the percentage of completion in accordance with IAS 11 *Construction Contracts*. The write-off of accumulated actuarial gains and losses on a change in accounting policy will change the estimated costs to complete a contract, because those actuarial gains and losses are excluded from the contract costs after the accounting change. For contracts that include capitalized actuarial gains and losses, this results in a cumulative catch-up adjustment. IDG members recommended that the IFRIC be encouraged to address the accounting treatment of the cumulative catch-up adjustment. In particular, the issue is whether the adjustment results from: (a) a revision of an estimate, requiring prospective treatment and recognition of the adjustment in profit and loss; or (b) an accounting policy choice upon transition, requiring recognition in equity at the time of the change in accounting policy. A communication to that effect has subsequently been submitted to the IFRIC Chairman from AcSB staff.

IFRS 1 and IAS 24: Related Party Transactions

Canadian GAAP contains requirements for the recognition and measurement of related party transactions. However, IAS 24 *Related Party Disclosures* does not specify any particular recognition and measurement requirements for related party transactions. IFRS 1 requires the retrospective restatement of balances on transition to IFRSs in the absence of any prescribed exemption. The issue raised was what, if any, restatements would be required for related party transactions on transition to IFRSs from Canadian GAAP.

IDG members recommended that no request be made to the IFRIC on this issue, because it is only a problem for Canadians transitioning to IFRSs, without global implications. However, IDG members did suggest that it might be useful for AcSB staff to develop a commentary that would help entities determine what questions they need to ask in evaluating whether restatement of past related party transactions is necessary on transition to IFRSs.

IAS 1: Inclusion of Additional Statements in Financial Statements

Paragraphs 10-14 of IAS 1 *Presentation of Financial Statements* provide guidance on what comprises a complete set of financial statements. The issue considered by the IDG was whether IAS 1 limits what statements can be included in a set of financial statements, both when the inclusion does and does not conflict with IFRSs.

Several IDG members noted that there are examples of additional statements being included in financial statements prepared in accordance with IFRSs. Members noted that it would depend on the nature of the additional statement whether it is in conflict with IFRSs and, as such, whether it is acceptable in a set of IFRS financial statements. The example provided for the IDG's discussion results from proposed Canadian regulatory requirements. IDG members

recommended that no request be made to the IFRIC on this issue, because it would be triggered by a jurisdiction-specific regulatory requirement.

IAS 8 and IAS 16: Allocation into Components of Property, Plant and Equipment

IAS 16 *Property, Plant and Equipment*, paragraph 43, requires: “Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.” Canadian GAAP is similar but includes the words “significant separable components” and “when practicable.” The discussion focused on a Canadian entity that, in preparing for the transition to IFRSs, determines that an asset has more components than have been taken into account under Canadian GAAP. The issue raised was whether the change in accounting should be treated as a change in estimate or the correction of an error in Canadian GAAP financial statements for periods preceding the initial adoption of IFRSs.

IDG members recommended that no request be made to the IFRIC on this issue, because this is only an issue for Canadian entities transitioning to IFRSs. IDG members noted that if there is a change in estimate, entities should carefully assess whether the change in estimate should be reflected in the last Canadian GAAP financial statements before transition to IFRSs. Some members commented that egregious errors are not expected, but could arise in rare cases. It was noted that how to treat a change in the allocation to components was not the only problem of this type for Canadian companies on transition to IFRSs. For example, similar issues arise when an asset has been fully depreciated under Canadian GAAP, but the asset is still in use on transition to IFRSs.

IAS 12: Income Taxes — Substantive Enactment

IAS 12 *Income Taxes* permits the use of “substantively enacted” tax rates and laws when measuring tax balances but does not provide extensive guidance on when tax rates and laws become substantively enacted. IDG members were asked to consider whether the IFRIC should be requested to provide more, or different, guidance compared to that found in existing IAS 12.

While the IASB’s March 2009 Exposure Draft, “Income Tax,” proposed some clarification of substantive enactment, the IASB has indicated that its project on Income Tax will not continue in its current form. The IFRIC does not address issues when the IASB has a current project on the subject and, therefore, the IDG members agreed that the IASB should be encouraged to include, in any revision of IAS 12, the text from its March 2009 Exposure Draft clarifying the meaning of substantive enactment. A communication to that effect has subsequently been sent to IASB staff.

IAS 12: Income Taxes — Flow-through Shares

Current Canadian tax legislation permits entities meeting specified criteria to issue securities to investors whereby the deductions for tax purposes related to expenditures made previously, or in the future, may be claimed by the investors and not by the entity (commonly referred to as flow-through shares). When the entity issuing the securities incurs eligible expenditures and includes them in the carrying amount of related assets, the carrying amount of the asset may exceed the tax basis as a result of the entity renouncing those deductions to the investors. A deferred tax consequence may result. Canadian GAAP currently includes guidance on accounting for these securities in Section 3465, *Income Taxes*, and EIC-146, Flow-through Shares. On transition to IFRSs, this guidance will be withdrawn. IFRSs do not specifically address the accounting for flow-through shares or the related tax consequences arising from such transactions. However,

paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides guidance when IFRSs do not specifically apply to a transaction, and Canadians would need to consider these paragraphs when addressing the accounting for flow-through shares

IDG members commented that an issuer would need to assess first what had been issued, because the investor receives both an equity interest and a right to a stream of tax deductions. To assess whether the transaction meets the criteria for treatment as a compound financial instrument or a multiple element arrangement, the issuer should consider guidance in IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 18 *Revenue*, based on the facts of the situation. Some IDG members observed that in Appendix A of the November 2004 US Securities and Exchange Commission (SEC) publication “[International Financial Reporting and Disclosure Issues in the Division of Corporation Finance](#),” the view taken by Financial Accounting Standards Board staff on accounting for flow-through shares was outlined. AcSB staff noted that they had tried to find other jurisdictions in the world that had similar instruments, but had not identified any such instruments in that search. IDG members recommended that no request be made to the IFRIC on this issue, since the IFRIC is not inclined to address country-specific issues. Members agreed that it would be helpful to provide non-authoritative guidance setting out the questions that an entity might consider in determining an appropriate treatment for flow-through shares it has issued.

IAS 17: Calculation of the Implicit Interest Rate in a Lease

IAS 17 *Leases* includes guidance on the calculation of the implicit interest rate in a lease. Paragraph 4 of IAS 17 states: “The *interest rate implicit in the lease* is the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.” For additional guidance on how the residual value should be determined, some entities refer to the guidance in IAS 16 *Property, Plant and Equipment*. Paragraph 29 of the Basis for Conclusions to IAS 16 stresses that the residual value is “the amount that an entity could receive for the asset currently (at the financial reporting date) if the asset were already as old and worn out as it will be at the time the entity expects to dispose of it.” When inserting the residual value, determined in accordance with IAS 16, in the calculation of the implicit interest rate in IAS 17, some entities treat the residual value as if the value is already a present value. This has led to these entities treating the cash flow from the residual value as if it was received in the current period and not at the end of the lease term. Including the unguaranteed residual value as a current period cash flow, instead of as a cash flow at the end of the lease term, when determining the implicit interest rate of the minimum lease payments does not appear to reflect the economics of a leasing transaction. Several members observed that the residual value concept in IAS 16 is in relation to the amortization of assets, not the value of an asset at a point in time.

Some IDG members acknowledged that they could see how the standards were being read to arrive at the treatment described above. It was noted that the IFRIC will often try to resolve apparent conflicts between standards and provide guidance as to which standard should be applied when. Therefore, in this situation the IFRIC could be asked to respond to whether it is appropriate to apply the residual value concept in IAS 16, which was developed for purposes of determining amortization, to the calculation of implicit interest rates in IAS 17. IDG members noted that the IASB had amended the residual value concept in IAS 16 effective in 2005. AcSB

staff agreed to undertake further research into whether, at the time of amending IAS 16, the IASB considered the effects of that amendment on IAS 17.

IAS 19: Increasing Vacation Pay Entitlements

The guidance on short-term employee benefits in IAS 19 *Employee Benefits* includes specific references to vacation pay, but the guidance is only applicable to amounts due to be settled within twelve months of the end of the reporting period. Some organizations have vacation policies providing for an additional vacation allotment after a specified period of service, (for example, one extra week of vacation per year after the completion of ten years of service). The guidance in IAS 19 does address long-term employee benefits that are not due within twelve months of the period, but this guidance does not mention vacation pay.

IDG members held divergent views regarding whether an obligation for incremental vacation pay should be accrued during the period prior to the date an employee becomes entitled to receive it. IDG members requested that AcSB staff undertake additional research to see how other jurisdictions have approached this issue, including consulting with other national standard setters.

IAS 21: Functional Currency of an Investment Holding Company

A national standard setter requested comments on whether there is, or is expected to be, divergence in practice in Canada with regard to the determination of the functional currency for investment holding companies, particularly those with no, or minimal, operating activities of their own.

IDG members did not anticipate that there would be difficulties, because IAS 21 *The Effect of Changes in Foreign Exchange Rates* provides enough guidance, but they did acknowledge that the challenge is the many variations in individual companies' fact patterns. Members drew attention to paragraph 12 of IAS 21 that notes the need for management's judgment when the indicators are mixed and the functional currency is not obvious. The members agreed that the difficulty was in the application and such problems are not the type of issue that the IFRIC considers. Furthermore, because of the slight variations in facts that could give differences in the answer, IDG members thought that it would be difficult for the IFRIC to usefully interpret this question. IDG members recommended that no request be made to the IFRIC on this issue.