

IFRS Discussion Group

Report on the Public Meeting

September 28, 2011

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board regarding issues arising on the application of International Financial Reporting Standards (IFRSs) in Canada. The Group is comprised of 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 Accounting Standards Board (AcSB). The discussions of the Group do not constitute official pronouncements or authoritative guidance.

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

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

(For a full understanding of the discussions and views expressed at the public meeting, interested parties should listen to the recording of the full discussion [here](#)).

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ITEMS PRESENTED AND DISCUSSED AT THE SEPTEMBER MEETING

Quarterly IFRS Financial Statements

Public companies with a calendar year end have filed two quarterly financial statements under IFRSs. Group members from two of the provincial securities regulators summarized their review activities to date, extent of deficiencies noted in their reviews and actions taken.

Lara Gaede, Chief Accountant of the Alberta Securities Commission, noted areas of focus in the regulators' reviews of interim reports and provided observations about areas that were handled well, such as the disclosure of IFRS accounting policies, and areas that required improvement, such as the clarity in mixed GAAP tabular presentations in the financial statements. Ms. Gaede noted that future areas of interest in regulatory reviews include impairment, business acquisition disclosures, the accounting for warrants issued in a currency different from an entity's functional currency and disclosure relating to fair value measurements.

Cameron McInnis, Chief Accountant of the Ontario Securities Commission, added observations about additional GAAP measures (previously referred to as “non-GAAP measures”) presented in the financial statements, including details about the work of staff on this topic and staff expectations. Group members asked several questions about the observations and findings relating to the use of these alternative measures. Mr. McInnis provided some specific examples of concerns with additional GAAP measures and matters of interest that filers should expect will be looked at more closely. Group members expanded the discussion to include:

- observations about approaches taken in other jurisdictions to address concerns with these alternative measures; and
- the broader challenges facing regulators, advisors and preparers in achieving a consistent application of IFRSs at an international level.

IFRS Interpretations Committee

Gord Fowler, Chair of the Accounting Standards Board (AcSB), provided the Group with information about recent developments regarding the International Accounting Standard Board's (IASB) interpretative body, the IFRS Interpretations Committee.

Mr. Fowler summarized steps taken by the AcSB regarding the IFRS Interpretations Committee's discussion on March 10, 2011 about whether credit risk should be included in the discount rate when applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. He explained that the AcSB wrote a letter to the Chairman of the IFRS Foundation Trustees Due Process Oversight Committee, dated April 28, 2011, to highlight the AcSB's due process concerns surrounding the IFRS Interpretations Committee's discussion. He noted that the AcSB's concerns were taken very seriously by the Trustees. The Trustees' Due Process Oversight Committee responded formally in a letter dated July 27, 2011.

Mr. Fowler noted that Mr. Wayne Upton, Director of International Activities at the IASB, has been appointed Chair of the IFRS Interpretations Committee by the Trustees of the IFRS Foundation. Mr. Upton's first meeting as Chair was the September 2011 meeting.

The Trustees are considering the results of their review of the effectiveness of the IFRS Interpretations Committee and are expected to make decisions by November 2011 on any changes that may be necessary, including whether the Committee's current approach to reporting agenda decisions will continue.

IAS 28: Losses in an Associate

IAS 28 *Investments in Associates* requires investments in associates to be accounted for using the equity method. Paragraph 29 of IAS 28 addresses the application of the equity method when an investor's share of losses of an associate equals or exceeds its interest in the associate:

If an investor's share of losses of an associate equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate. Such items may include preference shares and long-term receivables or loans but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognised under the equity method in excess of the investor's investment in ordinary

shares are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (ie priority in liquidation).

The issue considered by the Group was what percentage should be used to record losses of an associate when the carrying amount of the equity investment in the associate has been reduced to zero and the investor has more than one type of investment in the associate (for example, an equity investment in shares and a long-term loan for which settlement is neither planned nor likely to occur in the foreseeable future):

View A – The investor should recognize equity method losses based solely on its percentage of equity held (i.e., shares).

View B – The investor should recognize equity method losses based on the investor's ownership level of the particular investee security/loan (i.e., the portion of the loss funded by the investor's equity contribution plus any remaining portion of the loss funded by the loan provided by the investor).

View C – The investor should recognize equity method losses based on the change in the investor's claim on the investee's net book value.

View D – An entity can make an accounting policy choice and select View A, View B or View C.

The Group's discussion initially focused on Views A and B. Group members observed that the equity loss under View A, combined with the subsequent consideration of impairment, may often produce a similar income statement effect to the loss recorded under View B. Although some expressed a preference for View A, others observed that IAS 28 does not specify what percentage should be used when applying the equity method to these specific facts and circumstances and that different methods could reasonably be applied if the overall result makes sense.

Group members noted that, regardless of the approach taken to recognizing losses of an associate, IFRSs clearly require an entity to consider whether it is necessary to recognize an impairment loss after applying the equity method. Group members debated how the guidance in IAS 28 on impairment losses, along with paragraph 2(a) of IAS 39 *Financial Instruments: Recognition and Measurement*, should be applied. Group members noted that for this particular

fact pattern, different views may exist on how the requirements of IAS 36 *Impairment of Assets* and IAS 39 should be applied and what unit of account is appropriate when considering impairment (i.e., should the loan receivable and equity investment be considered together as a single unit of account or separately as individual assets).

Group members considered whether this issue should be brought to the attention of the IASB or the IFRS Interpretation Committee, and noted that the different approaches would not likely result in significantly different outcomes in most circumstances and the specific fact pattern was not common. As a result, the Group members agreed that this issue should not be brought to the attention of the IFRS Interpretations Committee.

IAS 32: Classification of a Liability Following a Change in Functional Currency

IAS 32 *Financial Instruments: Presentation* establishes principles for presenting financial instruments as liabilities and equity, including whether contracts settled in an entity's own equity instruments are financial liabilities or equity instruments. Paragraphs 21-24 of IAS 32 address the classification of a contract that involves settlement in an entity's own equity instruments.

Paragraph 22 of IAS 32 states that “a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument.” This requirement is often referred to as the “fixed for fixed” criterion. If this fixed for fixed criterion is not met, an instrument would be considered a financial liability. For example, an instrument denominated in a currency other than the entity's functional currency would be classified as a financial liability because this instrument is considered to violate the fixed for fixed criterion.

The IFRS Interpretations Committee has previously issued agenda decisions on IAS 32 that provide further information on the application of IAS 32 (see “Convertible instruments denominated in a foreign currency” on page 2 in the [April 2005 IFRIC Update](#) and “Changes in the contractual terms of an existing equity instrument resulting in it being reclassified to financial liability” on page 7 in the [November 2006 IFRIC Update](#)).

The issue considered by the Group was whether a change in functional currency subsequent to initial recognition that results in the financial instrument now meeting the fixed for fixed criterion should result in reclassifying the financial liability to equity:

View A – The instrument is not to be reclassified

Paragraph 15 of IAS 32 requires an instrument to be classified as a financial liability or equity instrument on initial recognition. This requirement can be interpreted to mean that classification occurs only on initial recognition and it is not subsequently revisited. This view is further supported by paragraphs IG35 and IG36 in the implementation guidance in IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* and IFRIC 9 *Reassessment of Embedded Derivatives*.

View B – The instrument should be reclassified

The definitions of financial liability and equity are in the present tense and imply that the definitions are to be applied at each reporting period. The references cited in View A are not relevant because IFRIC 9 is an interpretation of standards other than IAS 32 or they are not authoritative.

View C – Select View A or B

An entity can make an accounting policy choice to either reclassify or not reclassify the instrument because IAS 32 does not provide specific guidance. This accounting policy should be followed consistently.

Some Group members observed that the various references to the standards cited in support of each view were not particularly convincing. Group members were concerned that under View A an entity could have two identical instruments with different classifications solely because the two instruments were issued at two different points of time (i.e., one issued before a change in functional currency and the other after that change). Some noted that, although View A is supported by a narrow reading of the standard, given that functional currency was the key in determining the initial classification, a change in functional currency should reasonably be considered in assessing classification subsequently. Others noted that the paragraphs added to IAS 32 in the February 2008 amendments “Puttable Financial Instruments and Obligations

Arising on Liquidation (Amendments to IAS 32 and IAS 1)” (i.e., paragraphs 16A to 16F) would not have been necessary if the IASB intended entities to change initial classifications generally. Some observed that IFRIC 9 should be applied by analogy and others noted that *The Conceptual Framework for Financial Reporting* supports a different approach.

Some Group members acknowledged they hadn’t previously considered whether an instrument should be reclassified but thought that there was a need for further consideration of the measurement basis and whether the change in functional currency triggers derecognition.

Group members observed that the existence of a number of IFRIC agenda decisions and the subsequent amendments to IAS 32 in 2008 contributes to the overall confusion surrounding this issue. The Group observed that in 2005 the IFRS Interpretations Committee asked the IASB to consider addressing this issue and the IASB had drafted proposed amendments. However, the IASB did not proceed with those proposed amendments.

The Group concluded that the issue should not be brought to the attention of the IFRS Interpretations Committee because the issue is multi-faceted and a change in functional currency is not expected to occur for most entities. Group members noted that this issue is most likely to be resolved if the IASB decides to complete its project on financial instruments with the characteristics of equity or add a project to its agenda on foreign currency.

IFRIC 14: Minimum Funding Requirements

IFRIC 14 *IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* addresses how a minimum funding requirement might affect the availability of reductions in future contributions. In March 2011, the Group discussed the application of the minimum funding requirements in accordance with IFRIC 14.

Paragraph 21 of IFRIC 14 specifies that an entity “shall estimate the minimum funding requirement contributions for future service taking into account the effect of any existing surplus.” In March 2011, members discussed two approaches for determining a minimum funding requirement for future service, specifically, how the words “the effect of any existing surplus” in paragraph 21 of IFRIC 14 should be applied.

View A – Existing surplus at the current time

The “effects of the existing surplus” are limited to the amount of the surplus at the present time. Expected future growth in the current surplus would not be included.

View B – Existing surplus including growth

The “effects of the existing surplus” include growth in the surplus due to expected returns on plan assets exceeding the discount rate. Changes to the surplus due to any other factors would not be included.

The Group’s discussion in March 2011 demonstrated that there was support for both views, and these two approaches can result in significantly different outcomes and cause a lack of comparability across sectors. The Group noted that clarification of whether “the effect of any existing surplus” should include growth in the surplus would be helpful. However, Members questioned if the measurement of minimum funding requirements was a Canadian-specific issue or one that affected other jurisdictions. As a result, at the March 2011 meeting, the Group:

- recommended that the staff perform additional research to determine whether there is diversity in practice in other jurisdictions; and
- tentatively recommended that the AcSB consider bringing this issue to the attention of the IFRS Interpretations Committee if sufficient evidence of global diversity is found.

At the September 2011 meeting, the staff reported that the additional research performed has not identified any other jurisdiction where this issue is viewed as a significant issue that needs to be addressed. The staff noted that no significant diversity in practice outside of Canada has been found. In light of the staff’s research, the Group reconsidered whether the issue should be brought to the attention of the IFRS Interpretations Committee by the AcSB in a request for an interpretation.

Group members observed that diversity in practice exists in Canada but acknowledged that based on the IFRS Interpretations Committee’s current approach and agenda criteria, the issue should not be brought forward at this time. Instead, the Group directed the staff to continue to keep the IASB staff informed and monitor the work of the Canadian Institute of Actuaries and the International Actuarial Association on this issue. Also, the Group directed the staff to draw this issue to the attention of the IASB staff as an example that demonstrates one problem with the IFRS Interpretations Committee’s current agenda criteria.

The Group plans to reconsider this issue after any changes to the IFRS Interpretations Committee's approach or agenda criteria resulting from the Trustees review are implemented.

Issues Submitted but Not Brought Forward

After a preliminary assessment of issues submitted to the IFRS Discussion Group, some issues are not brought forward for a detailed discussion. This session allows the full membership to evaluate these issues and provide reasons why the issue should or should not be discussed at a future meeting.

IAS 27: Intercompany Gain/Loss with a Rate-regulated Subsidiary

Paragraph 20 of IAS 27 *Consolidated and Separate Financial Statements* requires intragroup balances, transactions, income and expenses to be eliminated in full. Under pre-changeover Canadian GAAP, *Consolidated Financial Statements*, paragraph 1601.18, included an exception to recognizing the intercompany gain or loss when a parent or subsidiary manufactures or constructs facilities for a regulated public utility in the consolidated group. The issue submitted arises because IAS 27 does not include an exception that is similar to the exception under pre-changeover Canadian GAAP.

The Group's Agenda Setting Committee did not add this issue to the agenda because the issue did not meet the Group's agenda criteria:

1. Does the issue arise from the application of IFRSs in Canada?

No. The issue does not arise from the application of IFRSs because an exception does not exist to the requirement to eliminate in full intragroup balances, transactions, income and expense in paragraph 20 of IAS 27 relating to rate-regulated entities.

2. Is the issue widespread in Canada?

No. The circumstances described by the submitter are not expected to occur frequently in practice in Canada. This issue appears to be fairly narrow and relates to the submitter's specific facts and circumstances.

3. Is there significant divergent practice, or the potential for significantly divergent practice, within Canada?

No. The Agenda Setting Committee does not expect significantly divergent practice to emerge in Canada because IAS 27 is clear. The Agenda Setting Committee noted that the submitter's concern needs to be addressed as part of a broader project on rate-regulated accounting. A rate-regulated activities project is a topic for consideration in determining the IASB's future agenda.

The Group agreed with the Agenda Setting Committee's decision not to add this issue to the agenda for the reasons noted above.

UPDATE ON PREVIOUS ITEMS DISCUSSED BY THE GROUP

The IFRS Discussion Group's Mandate

At the June 2011 meeting, members considered how to clarify the Group's objectives and improve communications to stakeholders. The Group recommended that the AcSB change the Group's purpose and responsibilities to explicitly include an objective to raise awareness of issues arising in Canada from the application of IFRSs as issued by the IASB. The AcSB considered the Group's recommendation and the issue of communications with stakeholders at its July 2011 meeting.

The AcSB agreed with the Group's recommendation to expand the Group's mandate to include raising awareness in Canada of issues arising from the application of IFRSs as issued by the IASB that are not expected to result in a submission to the IFRS Interpretations Committee or the IASB. The AcSB also approved the Group's request to issue more detailed meeting reports that would provide more value to stakeholders. The AcSB emphasized that the expanded meeting reports are not authoritative and should reflect research conducted by the Group's members and comments made in its meetings that would assist Canadians in exercising their judgment when IFRSs permit a choice.

IAS 17: Changes in the Terms of an Operating Lease Agreement

At the June 2011 meeting, Group members discussed whether a modification to the terms of an operating lease agreement should be viewed as a continuation of an existing lease or creation of a new lease. Although members noted some diversity may emerge in the short-term, the Group recommended that this issue not be brought to the attention of the IFRS Interpretations

Committee because diversity is not expected after the new standard on leases is issued and in effect.

After the Group's June 2011 meeting, the AcSB staff had the opportunity to bring the issue to the attention of the IASB project staff. The IASB staff will consider the examples discussed by the Group and whether to clarify the proposed guidance. A re-exposure draft on leases is expected and AcSB staff will follow up on this issue when the re-exposure draft is issued.

UPDATE ON OUTREACH REQUESTS FROM THE IFRS INTERPRETATIONS COMMITTEE STAFF

As noted at the Group's June 2011 meeting, the responsibilities of the Group include providing information on requests for advice from the IASB, national standards setters or similar bodies regarding eligibility of issues for possible IFRS Interpretations Committee interpretations.

AcSB staff circulate these outreach requests to Group members and ask for information about the prevalence of the issue in Canada and the level of diversity in practice that forms the basis for the AcSB staff response to the IFRS Interpretations Committee staff on each issue.

Since the Group's June 2011 meeting, the AcSB staff responded to three outreach requests and the IFRS Interpretations Committee continued its work on these issues at its September 2011 meeting:

- IFRS 3 *Business Combinations* – definition of a business;
- IFRS 11 *Joint Arrangements* – acquisition of interest in a joint operation; and
- IAS 7 *Statement of Cash Flows* – classification of business combination cash flows.

For further details, refer to the work in progress section in the [September 2011 IFRIC Update](#).