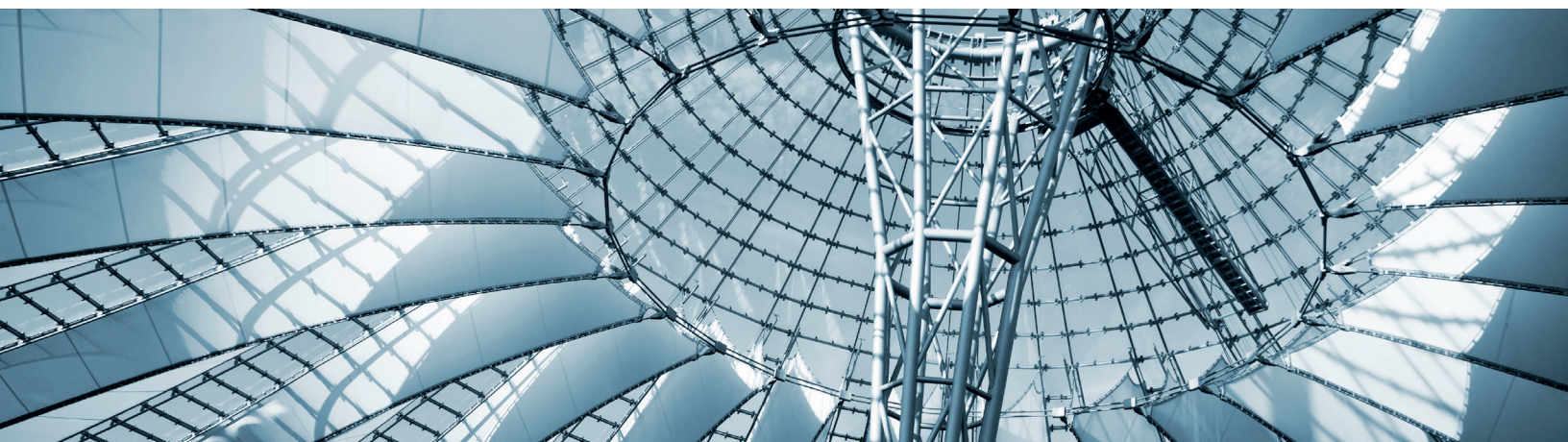


FINANCIAL REPORTING BULLETIN

Annual publication on accounting updates in Canada – 2015



Here is the *Financial Reporting Bulletin* from Mazars in Canada. This annual publication on accounting updates in Canada is intended as a guide for CFOs, executives, and managers responsible for financial reporting matters, and for audit committee members as they assess how new and revised financial reporting standards will affect their companies.

In this edition we provide brief to-the-point summaries of recent major financial reporting developments for commercial enterprises and not-for-profit organizations. We cover standards that became effective in 2015 and those that will take effect in later years, including ASPE standards on consolidation and on joint arrangements, as well as a status update on the project on shares issued in a tax planning arrangement, and IFRS standards on revenue recognition, financial instruments and the new standard on lease accounting, all of which could have a significant impact on financial reporting.

We also take a look ahead at the major projects that CPA Canada and the IASB are currently working on that could result in new standards being issued in 2016 and beyond, including those on accounting for income taxes and the equity method. 2015 was a busy year for the accounting standards setters, and the next few years promise to be just as busy. We'll keep you informed.

Enjoy reading!

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Strategic plan initiative (2016-2021)

The initiative will help develop the the AcSB's next strategic plan. The AcSB will take into consideration the experiences from applying current accounting frameworks and input from stakeholders on how to improve the implementation of its strategies.

The initiative comprises two components:

- The objective of the first component is to confirm that the strategy for each accounting framework is still appropriate.
- The objective of the second component, based on a review of the first, is to determine how the AcSB can better implement its strategies.

In 2015, the AcSB published for comment a draft version of its strategic plan. The AcSB analyzed a draft version of its definitive strategic plan at the end of 2015.

Strategies for the major categories of reporting entities are unchanged from the 2011-2016 strategic plan and are as follows:

- Publicly accountable enterprises: support the application in Canada of IFRS;
- Private enterprises: maintain the new set of standards established in 2011 for this sector (i.e. do not converge with IFRS);
- Not-for-profit organizations (NFPOs): maintain the separate set of standards that address the specific needs of NFPOs. For non-specific needs, direct NFPOs to Part II;
- Pension plans: maintain the separate set of standards in Part IV.

Update on Accounting standards for private enterprises – ASPE

When it published the ASPE accounting framework, the AcSB committed to limiting the frequency of changes to the standards to ensure a cost-benefit balance for financial statement preparers and users.

ASPE are updated in two ways:

- Through major improvements;
- Through annual improvements.

Major improvements are carried out by issuing a new section or redesigning a standard, whereas annual improvements are designed to clarify the guidance or wording of existing standards or to correct relatively minor inconsistencies, conflict or oversights. Annual improvements are therefore limited in scope and applicability.

New standards

No new ASPE standards were published in 2015; however two standards issued in 2014 will become effective in 2016 and are required to be applied retrospectively. Consideration must therefore be given immediately to the impact that these new standards may have on your organization's financial statements. Major changes are summarized below.

Joint Arrangements

In 2014, the AcSB published Section 3056, *Joint Arrangements*, that replaces Section 3055, *Interests in Joint Ventures*, and amends Section 3051, *Investments*. These new standards are effective for fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

Section 3056 retains the key principle of IFRS 11, *Joint Arrangements*, which is that the investor's interest in a joint arrangement is recognized on the basis of a transaction's economic substance.

Under the current standard, an entity can choose to recognize its interests in joint ventures – now called “joint arrangements” – using the proportionate consolidation, equity or cost method. The new section eliminates the proportionate consolidation method and limits the choice in selecting an accounting method in order to provide a fair presentation of the nature of an entity's interests.

Thus, a distinction is drawn between the interests in a joint arrangement where an entity:

- Has rights to the joint arrangement's assets and obligations for its liabilities (“Joint operations” / “Joint assets”);
- Has rights to the joint arrangement's net assets (“Jointly controlled enterprises” – separate legal entities).

Joint operations and Joint assets

The new standard requires investors with interests in joint operations or joint assets to recognize their interests in the joint arrangement's assets, obligations, revenues and expenses. Although similar to proportionate consolidation, this method can generate different results depending on the characteristics of the agreement.

Jointly controlled enterprises

The new standard allows investors to account for their interests in a jointly controlled enterprise under the equity method or the cost method. Investors having a direct interest in an enterprise's assets and liabilities, rather than an interest in its net assets, may, as an accounting policy choice, perform an analysis of all their interests in jointly controlled enterprises to determine whether they have an interest in an enterprise's net assets or in its individual assets and liabilities. Following such analysis, interests in jointly controlled enterprises identified as representing interests in individual assets and individual liabilities must be accounted for by recognizing the interests in each individual asset and liability.

Contributions and transactions

For contributions to a joint arrangement, the requirement in Section 3055 to defer and amortize the portion of a gain that does not relate to the amount of cash or fair value of other assets received has not been retained in Section 3056 because it did not meet a cost/benefit test.

Amendments were also made to certain paragraphs in Section 3051 to provide clearer guidance on how to account for transactions (including contributions) between an investor and an equity-accounted investee.

Transitional provisions

Section 3056 includes specific provisions for the transition from the proportionate consolidation method to the cost or equity method and for the transition from the cost or equity method to accounting for the investor's interests in the individual assets and liabilities of a joint arrangement.

Potential impact of the new standard

The impact on financial statements could be significant for enterprises using the proportionate consolidation method under which joint venturers recognize, on an item by item basis, their share of a joint venture. As such, joint venturers may now be required to use the equity method, which affects only the investments recorded on the balance sheet and the proportionate share of earnings. These amendments could have a substantial impact on the determination of the principal covenants under which an enterprise operates, potentially requiring a review of agreements with its creditors.

Subsidiaries and Investments – Consolidation

In 2014, the AcSB issued Section 1591, *Subsidiaries*, to replace Section 1590, *Subsidiaries*, as well as Accounting Guideline AcG-15, *Consolidation of variable interest entities*. AcG-15 is viewed in practice as complex and difficult to understand and apply. The new standard is effective for fiscal years beginning on or after January 1, 2016, with early application permitted. The new standard will affect entities that choose to prepare consolidated financial statements; entities opting to apply the cost or equity method to account for subsidiaries will not be affected.

The AcSB developed the new standard based on certain principles set out in IFRS 10, *Consolidated Financial Statements*. The new standard, however, takes into account specific features of private enterprises and contains clarifying guidance. The underlying principle is that control is not only a matter of a majority voting interest, but can also be vested in an entity through other means, such as contractual arrangements. However, contractual arrangements entered into by entities under common control are excluded from the scope of Section 1591. Such agreements should be accounted for according to their nature – e.g. as leases. This exemption would contribute to lowering costs for enterprises that prepare consolidated financial statements.

Under the current standard, an entity may choose to recognize its interests in subsidiaries using the consolidation, equity or cost method. The new section maintains this choice in selecting an accounting policy. In addition, the guidance for enterprises controlled through voting rights, as well as the definition of “control”, remain unchanged.

However, Section 1591 includes additional guidance requiring the use of judgment in determining whether factors other than the voting rights confer control. This guidance describes the conditions that an enterprise must meet to have control through contractual rights, and the circumstances that it should consider to determine whether or not it controls another enterprise. Judgment must be used when analyzing contractual rights, to distinguish protective rights from rights that confer control. Protective rights are designed to protect the interests of the party holding them, but do not confer decision-making authority over the operations of the other enterprise. Protective rights may take the form of approval or veto rights that allow the holder to participate in or prevent events or transactions that are not in the normal course of the enterprise's operations.

Transitional provisions

To limit the costs associated with adopting the new standard, transitional provisions offer a measure of relief for enterprises that previously prepared consolidated financial statements and for enterprises that choose to prepare their initial consolidated financial statements upon implementation of the new standard. Relief is also provided for enterprises that will no longer be required to consolidate a previously consolidated entity.

Potential impact of the new standard

Although it is not expected that adoption of the new guidance will have a significant impact, the amendments could materially affect the financial statements of an enterprise that prepares consolidated financial statements, because the criteria for determining control through means other than voting rights differ from those used in AcG-15. Thus, some entities may now be required to consolidate subsidiaries for the first time, and some entities may need to “deconsolidate” certain subsidiaries. In any case, an in-depth analysis of all right-conferring agreements will have to be performed.

Annual improvements to ASPE

2014

The changes are effective for fiscal years beginning on or after January 1, 2015. Earlier application is permitted. The following amendments have been made to Section 3856, *Financial Instruments*:

Hedging

When a reporting period ends between the date the hedged transaction occurs and the date the hedging item matures, the AcSB has clarified that the hedging item is remeasured using the spot rate in effect at the balance sheet date, with any gain or loss included in income.

Allowance for doubtful accounts

Section 3856 requires that the amount of an allowance for impairment of financial assets and the value of impaired assets be disclosed by asset type. As the allowance for doubtful accounts is often determined on a group basis rather than for each balance or invoice, it had become difficult to determine the carrying amount of each impaired asset, and the standard was applied differently from one entity to the next. The AcSB concluded that the original disclosure rule for impaired assets did not apply to the allowance for doubtful accounts and that the disclosure requirement for trade receivables was limited to the total amount of the allowance.

2015

The changes are effective for fiscal years beginning on or after January 1, 2016 with earlier application permitted, and relate to the following sections:

Section 1582, Business Combinations

If a combination is carried out through the acquisition of assets rather than through the acquisition of shares, a number of disclosure requirements have been specified, especially as they relate to the amounts recognized at the acquisition date for each major class of assets acquired and liabilities assumed.

Section 3462, Employee Future Benefits

The AcSB has recommended changes to the wording of Section 3462, *Employee Future Benefits*, to clarify the circumstances under which a funding valuation can be used to determine an obligation under a defined benefit plan. It has also recommended that a decision tree be included to help preparers understand its guidance.

In addition, the AcSB proposes to clarify that funding valuations that are required to be prepared under legal or contractual obligations (e.g. under the *Income Tax Act* in the case of supplemental pension plans for executives) are authorized.

Sections 3051, Investments and 3065, Leases

The AcSB has recommended that Sections 3051, *Investments*, and 3065, *Leases*, be amended to require the disclosure of the amount and details of any impairment loss or reversal of a previously-recognized impairment loss.

ASPE projects

Exposure Draft – Redeemable Preferred Shares Issued in a Tax Planning Arrangement

Questions have been raised about redeemable preferred shares issued in a tax planning arrangement, specifically with respect to their scope, reclassification and valuation. The AcSB has discussed these issues and concluded that they extend beyond the framework of annual improvements. Accordingly, it was agreed that these questions would be dealt with in a separate project.

In 2014, the AcSB issued an exposure draft with a view to eliminating paragraph 3856.23 from ASPE, which requires that redeemable preferred shares issued in a tax planning arrangement under specific sections of the *Income Tax Act* (e.g. in the case of an estate freeze) be accounted for as equity at par value, even though they are redeemable and in line with the definition of a financial liability.

According to the AcSB, the proposal would reflect the economic substance of a transaction and make it clear that such preferred shares represent their holders' claim on the resources of the enterprise.

Under the AcSB's proposal, these shares would be reclassified as liabilities, at their redemption value. The impact of this reclassification would be recognized under a separate item in equity. The changes would have significant repercussions on the balance sheet of enterprises that have issued redeemable shares in the past as part of eligible rollover transactions.

This could have a material impact on the determination of the principal covenants under which an enterprise operates, potentially requiring it to review agreements with its creditors.

After receiving approximately 70 letters commenting on its exposure draft (which is more than five times the number of comment letters it usually gets), the AcSB undertook a more in-depth examination of respondent comments through roundtable discussions with stakeholders and other endeavours.

As a result:

- The AcSB will finalize its work and wait until it has examined feedback from the request for comments on the 2016-2021 Strategic Plan before formulating any conclusions;
- No change relating to paragraph 3856.23 will be implemented prior to January 1, 2018 (as opposed to January 1, 2016 in the exposure draft);
- A number of approaches may be contemplated:
 - maintain the exception – given the applicability problems noted, this approach is probably not feasible, since amendments will no doubt be required; according to the AcSB, a standard that is not applied consistently is not sufficiently clear, and must be amended;
 - develop an alternative solution;
 - eliminate the exemption – exposure draft's proposal to eliminate paragraph 3856.23 and treat these shares as financial liabilities.

Agriculture

The AcSB is continuing to work on a project to account for biological assets held by agricultural entities. It was agreed that the AcSB would discuss the issue of whether biological assets are inventories or property, plant and equipment only after deliberating the feedback from the discussion paper. It was also agreed to recommend that agricultural produce and animals held for sale be measured at current value when certain conditions are satisfied, and at cost when they are not. Comments on the conditions that would help determine when a current value measurement is appropriate will be solicited from stakeholders.

The AcSB issued its draft discussion paper for comment on December 17, 2015.

Exposure Draft – Subsidiaries and Investments – Equity or Cost Method

Section 1591, *Subsidiaries*, provides enterprises with a choice of three methods to account for subsidiaries: consolidation, equity, or cost. As part of this project, which is designed to determine the accounting treatment of subsidiaries that are subsequently accounted for using the cost or equity method, the AcSB will use Section 1582, *Business Combinations*, to ascertain whether or not an enterprise should apply some of its requirements.

The major recommendations of the exposure draft are:

Initial measurement

- The cost of an interest in a subsidiary or in an investment subject to significant influence should be accounted for on a basis that is similar to other business combinations and therefore measured at the acquisition-date fair value of the consideration transferred, with related charges being recognized as they are incurred;
- Bargain purchase gains should not be recognized and acquisitions of additional interests should be measured at cost. In addition, the settlement of a pre-existing relationship should not be included in the cost of an investment and provisional amounts could be used when the initial accounting for the subsidiary is incomplete at the balance sheet date;
- When an additional interest is acquired, the total book value of the resulting investment should be the carrying amount of the interest immediately before the acquisition, plus the cost of the additional interest acquired. Acquisition-related costs on the previously-held interest capitalized in accordance with Section 3856, *Financial Instruments*, would continue to be included in the carrying amount of the interest.

Subsequent measurement

- Earnings from an interest in a subsidiary and investments subject to significant influence should be recognized in income when received or receivable;
- The provisional carrying amount of an interest in a subsidiary should be adjusted in a subsequent period when the provisional amount is finalized, which should not exceed one year from the acquisition date;
- The carrying amount of the retained interest in an investee after the sale of a portion of the interest in the subsidiary should be a proportionate share of the carrying amount of the subsidiary immediately prior to the transaction;
- Existing provisions relating to impairment should apply, as well as certain disclosure requirements.

Comments must be received by January 6, 2016. The changes would be effective for fiscal years beginning on or after January 1, 2018 and could be applied prospectively. Earlier application would be permitted.

Post-Implementation Review: Section 3856, *Financial Instruments*

The AcSB has carried out a post-implementation review of Section 3856, *Financial Instruments*, to assess the effect of this standard on financial statement users and preparers. This review, the first of its kind undertaken by the AcSB, will enable the Board to determine whether the standard has achieved its intended objectives. The post-implementation review covers the issues that were deemed important or contentious during the development of Section 3856 and addresses unanticipated implementation costs and problems.

The AcSB will analyze comments received in greater detail to determine if certain aspects of Section 3856 need to be amended.

Accounting Standards for Private Sector Not-for-Profit Organizations

In May 2015, the AcSB approved the creation of a standing not-for-profit advisory committee to assist it with its standards improvements initiatives, as well as provide input on other standard-setting matters of interest to private sector not-for-profit organizations. It also approved projects to address all of the principles relating to private sector standards that were proposed in the joint AcSB/PSAB Statement of Principles issued in April 2013.

The Statement of Principles contained 15 proposed principles. They are of varying interest to NFPOs, depending on the nature of each organization, its particular circumstances and whether it is in the private or public sector.

The job of improving private sector accounting standards will be carried out as follows:

Phase 1

This phase of the project addresses the proposals under which NFPOs:

1. Apply the accounting standards for private enterprises in Part II to report the capitalization, amortization and disposal of tangible capital assets and recognize write-downs to reflect a partial loss of service potential of a tangible asset still in use (Principle 5);
2. Continue to apply the existing Part III standards for intangible assets and add a requirement to Part III to recognize write-downs to reflect a partial loss of service potential of an intangible asset still in use (Principle 6);
3. Continue to apply the existing Part III standards for collections and add a requirement to Part III to recognize collections at either cost or nominal value (Principle 8);
4. Maintain the existing standards in Part III for:
 - a. works of art, historical treasures and similar items that are not part of a collection (Principle 9);
 - b. related party transactions (Principle 12);
 - c. allocated expenses (related to fundraising and general support costs) (Principle 15).

Phase 2

This phase of the project relates to whether, and how, to amend Section 4450, *Reporting Controlled and Related Entities by Not-for-Profit Organizations*, and addresses the proposals that:

1. Require consolidation of controlled NFPOs, subject to an exclusion from consolidation of a large number of individually immaterial organizations (Principle 10);
2. Require the application of the equity method to account for controlled profit-oriented enterprises although an organization would not be required to conform the accounting principles of the subsidiary with those of the parent (Principle 10);
3. Maintain the existing standards for definition and disclosure of economic interests (Principle 11);
4. Present expenses by function in the financial statements, disclose expenses by object in the notes, and present total fundraising and support expenses separately in the financial statements or disclose them in the notes (Principle 14).

Contributions – Revenue Recognition and Related Matters

This separate project will include:

1. Researching the recognition of revenue from contributions, as part of addressing the proposals that state:
 - a. pledges should meet the definition of an asset in order to be recorded. This is generally the case when an NFPO has received (cashed) the contribution or is contractually entitled to it. Accordingly, this proposal would have an impact on most pledges (gifts) that are not consistent with this principle (Principle 1);
 - b. a contribution should be recognized as revenue when it is received or receivable, except when, and to the extent that, it gives rise to an obligation that meets the definition of a liability; for example, an NFPO is required to satisfy specific conditions governing the application of funds obtained from a contributor, otherwise it will have to return the funds (Principle 2);
 - c. if a stipulation gives rise to a liability, revenue should be recognized where the liability is settled pursuant to Principle 2 (Principle 3);
 - d. contributions of goods and services may be recognized at fair value when such value can reasonably be estimated (Principle 4).
2. Addressing the implications of:
 - a. eliminating the size exemption for smaller organizations (average annual revenue of under \$500,000) in Part III that permits non-recognition of tangible capital assets and intangible assets (Principle 7);
 - b. applying the standards in Part II to the presentation of financial statements, subject to retaining guidance material in Part III that addresses unique financial statement presentation issues related to NFPOs (Principle 13).

The AcSB plans to issue an exposure draft for Phase 1 in 2016.

New standards

IFRS 15, *Revenue from Contracts with Customers*

In May 2014, the IASB and the FASB jointly published a new standard on revenue recognition. This eagerly-anticipated publication marks the completion of several years of work. It is designed to provide groups using IFRS with a more robust and comprehensive standard that covers all transactions, including the most complex, without having to refer to another body of standards or to develop interpretive guidance. Both Boards also sought to enhance the relevance of disclosures in notes to the financial statements.

Thus, IFRS 15 (ASU 2014-09 in the U.S.) sets out the revenue recognition principles that apply to all contracts entered into with a customer or client (with the exception of lease contracts, insurance contracts and contracts covered by standards governing financial instruments). In practice, IFRS 15 replaces IAS 18, “Revenue”, and IAS 11, “Construction Contracts”, (as well as all related interpretations (i.e. IFRIC 13, IFRIC 15, IFRIC 18 and SIC 31).

IFRS 15 specifies when an entity is required to recognize revenue (either at a given point in time or over time), and how much revenue to recognize. It is based on a model comprising five key steps:

- Step 1: identify the contract entered into with the client;
- Step 2: identify the performance obligations included in the contract;
- Step 3: determine the contract’s transaction price;
- Step 4: allocate the transaction price to each performance obligation;
- Step 5: recognize revenue when each performance obligation is satisfied.

Application guidance (dealing with such topics as a series of performance obligations and sales with the right of return), appended to IFRS 15, and a number of illustrative examples are also provided. This comprehensive standard eliminates all industry-specific guidance.

A number of entities have raised some implementation issues. As a result, the two Boards have set up a joint Transition Resource Group (*TRG*) to analyze several of these issues. The impact of IFRS 15 will vary across industries. IFRS 15 will also have an impact on processes and controls, as well as on each entity’s information systems.

Initial application of IFRS 15 has been delayed for a year, and the standard is now effective for fiscal years beginning on or after January 1, 2018. Earlier application is permitted. Transitional provisions set out the terms and conditions for a retrospective initial application, with substantial relief for entities choosing to account for the impact of the change in accounting policy as at January 1, 2018 for contracts that are not completed at that time (i.e. no restatement of comparatives is required in this case).

Exposure Draft – Proposed Clarifications to IFRS 15

On July 30, 2015, the IASB published an exposure draft of proposed clarifications to IFRS 15.

These clarifications deal with the following topics, which were previously addressed by the *TRG*:

- How to identify the performance obligations of a contract (changes would be made to illustrative examples);
- How to distinguish an agent from a principal (amendments to the standard and changes/additions to illustrative examples would be made);
- How to determine the nature of the rights granted under a license - whether it is a right to access or right to use (amendments to the standard and changes/additions to illustrative examples would be made);
- New transitional provisions would be added as would two new practical simplifications.

The IASB and the FASB did not reach the same decisions about the pre-effective changes required to the original document. Thus, the basis for conclusions in the IASB's exposure draft reflects the decision-making process used by both Boards for these issues and for issues addressed by the FASB but not by the IASB (collectability as part of contract identification in step 1 of the model for the new standard, price estimates in the event of a non-cash consideration, and presentation of sales tax collected from customers). The IASB is asking stakeholders for their opinion about the decisions that it has made on each of these issues.

If adopted, these changes will be applicable on a retrospective basis, with an effective date probably in line with the new implementation date for IFRS 15. In practice, these changes will therefore be applied transitionally as if they had always been part of the standard.

Comments on the exposure draft were due by October 28, 2015, and the revised text should be finalized early in 2016.

IFRS 9, *Financial Instruments*

In July 2014, the IASB published IFRS 9, *Financial Instruments*, to replace IAS 39, *Financial Instruments: Recognition and Measurement*.

The summary below is based on the final version of IFRS 9 published by the IASB on July 24, 2014.

IFRS 9 brings together the three phases of the project, (i.e. classification and measurement, impairment, and hedge accounting). Macro hedging is part of a separate IASB project.

The improvements introduced by IFRS 9 include the following:

- A logical and unique approach to the classification and measurement of financial assets that reflects the business model under which they are managed as well as their contractual cash flows;
- A single, forward-looking "expected loss" impairment model;
- An approach to hedge accounting more aligned with an entity's risk management activities.

Disclosure has been revised, with an overall objective of enhancing information for investors.

Classification and measurement

- Financial assets

IFRS 9 introduces a logical and unique approach to the classification of all financial assets, as either amortized cost or at fair value, including assets that contain embedded derivative features. In the latter case, the financial asset is classified in its entirety rather than being subject to complex bifurcation requirements. Two criteria are used to determine how financial assets are to be classified and measured:

- An entity's business model for managing its financial assets;
- The contractual cash flow characteristics of each financial asset.

For financial assets within the scope of IFRS 9, there are three types of business models:

1. A model whose sole objective is to hold financial assets in order to collect contractual cash flows: financial assets are measured at amortized cost;
2. A model whose objective is both to hold financial assets with a view to collecting contractual cash flows and to sell financial assets: under this model, financial assets are measured at fair value through other comprehensive income;

3. Financial assets that are not held in one of the foregoing two business models, which are measured at fair value through profit or loss.

IFRS 9 requires financial assets to be reclassified between categories when, and only when, the entity's business model for managing them changes, which is expected to be uncommon. When a reclassification is required, IFRS 7, *Financial Instruments: Disclosures*, requires disclosure of information about the reclassification.

- Financial liabilities

During the development of IFRS 9, most respondents felt that IAS 39 had worked rather well. As a result, IAS 39 treatment of financial liabilities is carried forward to IFRS 9 essentially unchanged, and most financial liabilities will continue to be measured at amortized cost.

IFRS 9 includes the same option as IAS 39, which permits entities to elect to measure financial liabilities at fair value through profit or loss if particular criteria are met.

The only issue that the IASB was told needed urgent attention was the volatility in profit or loss caused by changes in the credit risk of financial liabilities that an entity had elected to measure at fair value. Under IAS 39, when an entity's own credit quality declined, the decrease in the fair value of its liabilities resulted in a profit. Conversely, if its own credit standing improved, it resulted in a loss. Such results were deemed counterintuitive. Accordingly, IFRS 9 now requires changes in fair value attributable to increases or decreases in an entity's creditworthiness to be recognized in other comprehensive income; liabilities will continue to be measured in the balance sheet at fair value.

IFRS 9 allows early application of the provision to account for changes in fair value relating to an entity's own credit risk through other comprehensive income for financial liabilities recorded at fair value through profit or loss, without having to adopt IFRS 9 in its entirety.

Impairment

The IAS 39 model (the incurred loss model) delays recognition of credit losses until a credit loss event occurs. This rule was designed to limit the creation of "cushions" by entities to compensate for poor earnings in future periods. Moreover, IAS 39 uses multiple impairment models, making it difficult to apply.

IFRS 9 introduces a new, three-phase impairment model that will result in earlier recognition of expected credit losses. Specifically, the new standard requires entities to account for their expected credit losses as soon as the financial instruments are recorded, and to record anticipated losses on a more regular basis throughout the life of a loan.

The same impairment model will apply to all financial assets that are subject to impairment, regardless of the type or classification of the instrument, thus removing a major source of complexity from IAS 39.

Hedge accounting

IFRS 9 introduces a new model that aligns the accounting treatment with risk management activities which could result in the application of hedge accounting to transactions not previously permitted. In addition, these changes will provide users of financial statements with enhanced disclosure of an entity's risk management practices and of the impact of hedge accounting on the financial statements.

Transitional provisions

IFRS 9 is effective for fiscal years beginning on or after January 1, 2018. Early application is permitted. From February 2015, entities applying IFRS 9 for the first time must apply the version of the standard published in July 2014.

Note, though, that entities are allowed to apply the provision on accounting for changes in fair value relating to its own credit risk through other comprehensive income early without having to adopt IFRS 9 in its entirety.

Project – Interaction between IFRS 9 and the forthcoming standard on accounting for insurance contracts

At its September 2015 meeting, the IASB decided to table proposals that would allow businesses carrying out insurance activities to manage the application gap between IFRS 9, *Financial Instruments*, and the forthcoming standard on accounting for insurance contracts.

As this is a major issue in Europe, the IASB has proposed to amend IFRS 4, to address the temporary consequences of different effective dates of IFRS 9, *Financial Instruments*, and the new IFRS on insurance contracts that will replace IFRS 4. As proposed, either of the following two options would be available:

- An overlay approach;
- A deferral approach.

- Overlay approach

This option, which would be available to all entities that issue insurance contracts, would adjust profit or loss for any additional accounting volatility arising from qualifying financial assets.

Under this approach, if IFRS 9 and IFRS 4 are applied together, entities issuing insurance contracts within the scope of IFRS 4 would be permitted to reclassify from profit or loss to other comprehensive income some of the income or expense arising from designated financial assets that are measured at fair value through profit or loss in their entirety in accordance with IFRS 9 but would not have been measured that way pursuant to IAS 39.

- Deferral approach

This option would be a temporary exemption from applying IFRS 9 and would be available only to entities whose main activity is the issuance of insurance contracts. Under this approach, entities whose predominant activity is the issuance of insurance contracts would be allowed to postpone application of IFRS 9 until the earlier of (1) the effective date of the new insurance standard, or (2) January 1, 2021. Note that, even if the new insurance standard is not effective by January 1, 2021, the IASB expects that all entities will be applying IFRS 9 by that date.

Insurance Contracts

In 2013, the IASB issued an exposure draft for the development of a new, principle-based accounting and presentation model for all types of insurance contracts. This standard would replace IFRS 4, *Insurance Contracts*, a temporary standard that allows insurance carriers to continue using the full range of its existing accounting practices.

A very large number of comments were received, and respondents were mostly in favour of the new proposals. The IASB has spent a long time debating the major issues and they are still under deliberation. A final standard is expected to be issued late in 2016.

IFRS 16, Leases

IFRS 16 was issued on January 13, 2016.

The following summary is primarily designed for lessees (“tenants”), as the most significant effects of IFRS 16 are expected in their financial statements. For lessors (“landlords”), the new standard should, in practice, have a small impact on their accounts; in fact, the IASB has decided that no material change should be made to the current lessor model and criteria in IAS 17, *Leases*.

Definition

Throughout discussions, the IASB has supported a model aimed at recognizing all leases on the balance sheet of the lessee. With the final standard, however, the decision to record an asset or a liability under a lease on the balance sheet will no longer depend on the difference between an operating lease and a capital lease, but on the distinction between a lease and a service contract.

A lease should be defined as a contract that conveys to the client the right to use an asset for a specified period of time in exchange for consideration. There can be no lease unless the client controls the right to use an asset specified under the lease.

Control over the right to use an asset exists if the client:

- Has exclusive use of the asset throughout the term of the lease;
- Directs the use of the asset.

Distinguishing between a lease and a service contract: an issue that has become crucial

Although in many cases the distinction between a lease and a service contract will be obvious, this distinction should be carefully considered. Indeed, the decision will determine whether a contract is recorded on the lessee's balance sheet. Under the new rules:

- The lessee is required to record, for all leases, the right to use a leased good as an asset, in consideration of a liability for lease payments;
- A service contract should not be recognized on the balance sheet, because such a contract is deemed enforceable under which both client and the supplier fulfill their respective obligations as they arise.

Separation of lease and non-lease components

A lessee may choose not to separate lease components from non-lease components but rather to treat them as a single lease component. This option (an accounting policy choice) must be made for each asset class.

If a lessee decides to allocate consideration on a component-by-component basis, it must do so based on the relative value of the observable stand-alone prices of the contract components. In the absence of observable stand-alone prices, the lessee is required to estimate the stand-alone price of the contract components. Price allocation terms are consistent with the provisions of IFRS 15.

Determination of a lease term

- Initial assessment

The term of a lease is defined as the non-cancellable period during which the lessee has the right to use the underlying asset. This period should include periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option.

- Subsequent assessment

The term of the lease should be reassessed by the lessee only if a major change in circumstance or event occurs that is under its control, (e.g. if, during the term of the lease, the lessee makes material improvements to the underlying asset and in so doing acquires an interest in extending the lease). Conversely, a significant change in market conditions during the term of the lease that makes the exercise of an option probable will not trigger reassessment of the lease term.

Lessee accounting model

- Measurement

The IASB's primary objective was to end up with a single model for the recognition of all leases on a lessee's balance sheet. Under this model, recognition of a right-of-use asset arises from all leases granting the lessee the ability to use an asset throughout the term of the lease; as consideration, the lessee recognizes a lease liability equal to the discounted value of the lease payments.

- Discount rate

For purposes of discounting lease payments, the standard specifies that the rate the lessor charges the lessee would be appropriate or, failing that, the lessee's incremental borrowing rate (i.e. the rate at which the lessee would have borrowed, over a similar term and with similar collateral, any funds required to obtain an asset with a value similar to that of the leased asset, in a similar economic environment). It should be noted that the discount rate should be remeasured if the term of the lease is changed, or if the incentive nature of a purchase option is reexamined.

- Variable lease payments

The standard makes a distinction between variable lease payments based on an asset's use or performance and those based on an index or a rate. Variable lease payments based on an asset's use or performance (e.g. a percentage of sales), should be excluded from the measurement. They would be recognized in profit or loss as they arise. However, variable lease payments based on an index or a rate should be included in the initial measurement of the lease assets and liabilities.

- Initial direct costs

Initial direct costs (i.e. those that would not have been incurred had the lease not been entered into, such as commissions paid to obtain the lease), should be incorporated into the initial cost of the right-of-use asset.

- Subsequent recognition

The IASB has opted for a single model under which a lease would require separate recognition of any interest on lease liabilities and of the amortization of the right-of-use asset. Accordingly, the lessee will amortize the right-of-use asset (usually on a straight-line basis) over the term of the lease, and account for the lease liability on an amortized cost basis. Under this model, the total cost of the lease (amortization and interest) will therefore decrease over the term of the lease. Amortization and interest should be shown separately, in operating income and financial expenses, respectively.

Disclosure requirements

The primary objective of disclosure in notes to the financial statements is to enable users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases. In addition, lessees are required to provide certain quantitative information about its leases.

Sale and leaseback transactions

During its most recent deliberations, the IASB decided to clarify the recognition of sale and leaseback transactions (i.e. transactions in which an entity transfers an asset and leases it back).

- How to determine whether a sale has occurred

The standard specifies that the IFRS 15 criteria should apply to determine whether a sale has occurred; if a sale has not occurred, the transaction should be treated as a financing arrangement.

According to IFRS 16, recognition of a sale under a sale and leaseback transaction differs according to whether the sale gives rise to a gain or to a loss:

- A loss should be recognized immediately by the seller-lessee;
- A gain should be only partially recognized. Only that part of the gain relating to a residual interest in the underlying asset at the termination of the lease should be recognized, because what is being sold is the residual interest in the underlying asset and not the asset in its entirety (i.e. because the seller-lessee retains the right to use the underlying asset throughout the term of the lease).

Modifications

A lease modification is defined as any modification of the contractual terms that is not part of the general terms and conditions of the original lease. Note that the substance of a modification has precedence over its form.

A lease modification should be recognized by the lessee as a new lease (separate from the original lease) in the following cases:

- The lease conveys to the lessee an additional right-of-use asset not included in the original lease;
- The price of the additional right-of-use asset is consistent with its specific selling price.

Any lease modification that is not in keeping with the foregoing criteria and that changes the scope of the original lease will cause the lessee to remeasure its lease liability using a discount rate determined as at the date of the modification with a corresponding adjustment to the value of the right-of-use asset.

A lease modification that increases the scope of the lease or the amount of consideration paid will result in an increase in the value of the right-of-use asset equal to the amount of the remeasurement of the lease liability. A lease modification that decreases the scope of the lease or the amount of consideration paid will result in a reduction in the carrying value of the right-of-use asset (i.e. to reflect the partial or total sale) and in the recognition of a gain or loss proportionate to the reduction.

Sublease

The standard specifies that an intermediate lessor is required to recognize the main lease and the sublease as two separate contracts, except when the two leases can be combined.

Exemption or simplification measures

Based on comments from constituents, IFRS 16 includes exemptions or simplification measures for short-term leases, leases of small assets, and accounting at the portfolio level.

- Short-term leases

Lessees have the option not to record short-term leases as assets and liabilities. A lease is short-term if it does not exceed twelve months, incentive renewal options included.

- Small leases

Lessees also need not recognize small leases on the balance sheet. To qualify as «small», assets may not be dependent on, nor highly interrelated with, other assets not deemed to be small assets.

- Accounting at the portfolio level

An option is also available to allow an entity that leases a substantial number of assets having similar characteristics (e.g. leases for a fleet of similar automobiles) to measure and recognize right-of-use assets and lease liabilities at the portfolio level instead of on an individual basis. This option should greatly simplify the accounting treatment of multiple leases. It could also be applied by lessors.

Transitional provisions

An entity will be able to grandfather (subject to disclosure of this option) all leases outstanding as at the date of initial application of the new standard.

Initial application of IFRS 16 may be accomplished under either of the following approaches:

- A fully retrospective approach;
- A modified retrospective approach under which the entity would not have to restate comparative figures. The date of initial application would be the first day of the fiscal year during which the standard is applied, with the cumulative effect of the change recorded as an adjustment to opening retained earnings.

Conclusion

The new standard on leases represents a major change in the way leases are recognized. It will have a potentially significant impact on the financial statements of lessees, as all leases will be recognized on their balance sheets.

Accordingly, it will also have an impact on the key ratios used by entities (debt, return on assets, EBITDA, operating margin, etc.) and may require a review of some financial ratios. Moreover, although the mandatory effective date of IFRS 16 is from January 1, 2019, now is the time to begin preparing for the new standard.

Potential impacts

- For lessors:
 - Recognition substantially unchanged;
 - All leases will be classified as either finance or operating.
- For lessees:
 - For all leases, balance sheet recognition of a right-of-use asset and of a lease liability;
 - The total lease cost will remain the same but will decrease over the lease term due to interest expense; total lease cost will be split between operating and finance costs;
 - Variable lease payments based on the use of leased assets will not be included in the lease liability;
 - Some contracts may be deemed service contracts and thus will not be recognized on the balance sheet. An in-depth analysis will have to be undertaken to identify them;
 - Concepts – including control, treatment of lease modifications and price allocation among the various components – are consistent with those of IFRS 15;
 - Exemptions from balance sheet recognition for short-term leases and for small asset leases;

- Increased note disclosure required;
- Transitional conditions to avoid fully retrospective treatment, and to ease the burden of implementation.

IFRS 16 becomes mandatorily effective from January 1, 2019. Early application is permitted but only if IFRS 15, *Revenue from Contracts with Customers*, is applied as of the same date (or has already been applied). Thus, IFRS 16 may be early-applied in 2018 by all entities, and in 2017 solely by entities that are also early-applying IFRS 15 in 2017.

Accounting for the Acquisition of an Interest in Joint Operations

Amendments to IFRS 11, *Joint Arrangements*, require that, when an entity acquires an initial or subsequent interest in a joint operation that is a “business” as defined under IFRS 3, *Business Combinations*, all of the requirements of IFRS 3 and of any other applicable IFRS must be applied – in proportion to the acquirer’s share – if they are not inconsistent with the guidance of IFRS 11. Primary requirements of IFRS 3 that are not inconsistent with IFRS 11 include: (1) measurement of identifiable assets and liabilities at their fair value; (2) expensing of acquisition-related costs; (3) recording of deferred taxes resulting from the initial measurement of the identifiable assets and liabilities acquired or expensed; (4) recognition of goodwill; and (5) impairment tests (made at least annually) of a cash-generating unit to which goodwill has been assigned.

These changes are effective prospectively for fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

Acceptable Methods of Depreciation and Amortization

Clarifications of acceptable methods of depreciation and amortization amend IAS 16, *Property, Plant and Equipment*, and IAS 38, *Intangible Assets*, effective from January 1, 2016 to clarify that a depreciation or amortization method based on revenue generated by an activity that includes use of an asset is not an appropriate method, because revenue generated generally reflects factors other than the consumption of the economic benefits of the asset. Thus, it will no longer be acceptable to apply a depreciation or amortization method that allocates an asset’s depreciable (or amortizable) amount based on revenues generated.

The amendments are effective prospectively and earlier application is permitted.

Use of the Equity Method in Separate Financial Statements

Amendments to IAS 27, *Separate Financial Statements*, allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates. Previously, such investments had to be accounted for at cost or in accordance with IFRS 9, *Financial Instruments*. Under the equity method, dividends received must be recognized as a reduction in the carrying value of the investment (not in net income).

These changes are effective prospectively for fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

Investment Entities: Applying the Consolidation Exemption

Amendments to IFRS 10, *Consolidated Financial Statements*, IFRS 12, *Disclosure of Interests in Other Entities*, and IAS 28, *Investments in Associates and Joint Ventures*, clarify the application of the consolidation exemption to investment entities as follows:

- The exemption from preparing consolidated financial statements is also available to a parent entity that is a subsidiary of an investment entity (e.g. an intermediate parent entity);

- The requirement for an investment entity to consolidate a subsidiary applies only to subsidiaries that are not themselves deemed to be investment entities and whose main purpose is to provide services related to the parent's investment activities;
- In applying the equity method to its interests in an associate or a joint venture that is an investment entity, an investor may retain the fair value measurements that the associate or joint venture uses for its subsidiaries.

The amendments are effective for fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

Bearer Plants

Amendments to IAS 41, *Agriculture*, and to IAS 16, *Property, Plant and Equipment*, address the appropriate accounting for bearer plants (e.g. grape vines, rubber trees, and oil palms). Previously, under IAS 41, bearer plants were accounted for as biological assets measured at fair value less costs to sell. However, bearer plants – a subset of biological assets – are generally used in the production or supply of agricultural produce over several periods and are typically scrapped at the end of their productive lives. Once a bearer plant matures, apart from bearing produce, its biological transformation is no longer significant in generating future economic benefits. Indeed the only significant future economic benefit a bearer plant generates comes from the agricultural produce it creates. Accordingly, under the amended guidance, bearer plants will be accounted for pursuant to IAS 16, because their operation is thought to be similar to manufacturing. Note, however, that produce growing on bearer plants will continue to be accounted for at fair value less costs to sell.

These changes are effective for fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

IFRS projects

Draft Interpretation: Uncertainty Over Income Tax Treatments

Draft IFRIC Interpretation 2015-1, *Uncertainty over Income Tax Treatments*, would provide guidance in the determination of taxable profit/tax loss, tax bases, unused tax losses, unused tax credits and tax rates, in circumstances under which there is uncertainty over income tax treatments that may affect the application of IAS 12, *Income Taxes*. The IFRIC reached the following consensuses:

- Each tax uncertainty should generally be considered separately, except that some such uncertainties should be considered collectively if doing so would be a better predictor of resolution;
- In assessing whether and how an uncertain tax treatment affects the determination of taxable profit, etc., the assumption should be made that a taxation authority examining amounts reported to it has (1) the right to do so and, (2) full knowledge of all relevant information;
- If an entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, taxable profit or loss, tax bases, unused tax losses, and unused tax should be determined consistent with the tax treatment used or planned to be used in the entity's income tax filings. If an entity concludes that it is not probable that the taxation authority will accept an uncertain tax, the effect of uncertainty should be reflected in accounting for income tax by applying either (1) the single most likely amount in a range or outcomes, or (2) the sum of the probability-weighted amounts in a range of possible amounts, whichever amount is deemed to provide the better prediction of resolution.

Post-Implementation Review of IFRS 3, *Business Combinations*

On June 17, 2015, the IASB announced that it had completed its Post-Implementation Review (PIR) of IFRS 3 and published a report of the PIR results.

Based on its work, the IASB has concluded that generally a large number of stakeholders agree with IFRS 3, but the report also suggests that some aspects of the standard require further research. The IASB therefore examined the key comments and reflected on the steps to implement by prioritizing the various areas of focus. The following points are shown according to the priorities set by the IASB and warrant further investigation.

1. Effectiveness and complexity of testing goodwill for impairment (high priority)

IAS 36, *Impairment of Assets*, could be amended to improve impairment testing, with a view to simplification.

2. Subsequent accounting for goodwill (high priority)

This could be done by improving impairment tests. The IASB is also considering whether to develop a “depreciation and amortization” model that would preserve the usefulness of the financial information disclosed.

3. Challenges in applying the definition of a business (medium/high priority)

The IASB could attempt to clarify the definition of a business (and the related application guidance). In this context, the IASB could consider whether a market-participant approach is preferable to an entity-specific approach.

In addition, a number of differences (e.g. in accounting for deferred taxes) between a business combination and an asset purchase could be reduced, thereby relieving some of the pressure on the definition of a business.

4. Identification and fair value measurement of intangible assets such as customer relationships and brand names (medium/high priority)

The IASB will reassess the relevance of keeping some intangible assets separate from goodwill (e.g. customer relationships) and may also consider providing additional guidance on the identification and measurement of customer relationships.

Depending on the feedback received from its agenda consultation, the IASB could start working on other areas of focus. It is still too early to determine the actual impact of its Post-Implementation Review.

Exposure Draft – Classification and Measurement of Share-based Payment Transactions

In November 2014, the IASB issued an exposure draft to amend IFRS 2, *Share-based Payment*.

The proposed amendments are designed to clarify the following issues:

- Accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payments – the IASB proposes to clarify that accounting for these effects should follow the approach used for measuring equity-settled share-based payments;
- Classifying share-based payment transactions with net settlement features – the IASB proposes to require that a tax-withholding arrangement should be classified as equity-settled in its entirety (including the tax withheld), if in the absence of a tax withholding the plan would have been entirely settled by the issuance of equity instruments;
- Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled – the IASB proposes to amend the standard to require the following terms and conditions for recognizing such a modification:
 - the fair value of the transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification;
 - the liability recognized in respect of the original cash-settled share-based payment is derecognized, and the equity-settled share-based payment is recognized in equity to the extent that the services have been rendered up to the modification date; and
 - the difference between the carrying amount of the derecognized liability and the amount recognized in equity is recorded in profit or loss.

The IASB proposes that these amendments be applied prospectively, but also proposes to allow entities to apply the amendments retrospectively if they have the information needed to do so.

Comments were to be received by March 25, 2015. In November 2015, the IASB decided to finalize its draft amendments to IFRS 2.

Exposure Draft – Amendments to IAS 1 Clarifying the Criteria for the Classification of a Liability as Either Current or Non-current

The exposure draft clarifies that the classification of a liability is based on an entity's rights at the end of the reporting period; thus, a liability should be classified as non-current only if there exists, at the end of the reporting period, a right to defer its settlement for at least twelve months after the reporting period.

The exposure draft also clarifies that if an entity has the right to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it should classify the obligation as non-current, even if it would otherwise be due within a shorter period. However, when there is no right to roll over an obligation (e.g. there is no arrangement for refinancing in place at the end of the reporting period for doing so), the entity should not consider the potential to refinance the obligation and thus should classify the obligation as current.

Finally, exposure draft clarifies that the settlement of a liability refers to the transfer of cash, equity instruments, other assets or services that results in the extinguishment of the liability.

The proposed amendments would be effective retrospectively as of a yet-unspecified date. Comments were to be received by June 10, 2015.

Exposure Draft – Conceptual Framework for Financial Reporting

On May 29, 2015, the IASB published an exposure draft on its conceptual framework for financial reporting. Following a 30-day extension, comments were to be received by the IASB no later than November 25, 2015.

Divided into eight chapters and a basis for conclusions, this exposure draft states in its introduction that its objective is to:

- Help the IASB develop and review its standards;
- Assist businesses in developing consistent accounting policies when no standard applies to a particular transaction or event, or when a standard allows a choice of accounting policy; and
- Help all parties understand and interpret the standards.

The status of the conceptual framework in relation to IFRS standards remains unchanged; the standards still take precedence over the conceptual framework. However, the IASB is committed to explaining the rationale for any new provisions that are inconsistent with the conceptual framework in its basis for conclusions.

Although the document is titled *Conceptual Framework for Financial Reporting*, most of its proposals focus on IFRS-based financial statements and not on financial reporting, a much broader concept.

Far from revolutionizing the IFRS landscape, as is evident from the few differences between the current standards and this exposure draft, the proposed conceptual framework clarifies, redefines, and completes the existing framework in terms of fundamental financial statement characteristics and of cost-benefit constraints.

Potential impacts

The IASB has identified only two major inconsistencies between the existing standards and the proposed conceptual framework, which could be corrected over time by carrying out research projects on the appropriate topics. The new conceptual framework should have no short-term impact on existing standards. Due to the latitude allowed by the wording of the exposure draft, non-compliance with the conceptual framework would be limited.

Draft Interpretation: Foreign Currency Transactions and Advance Consideration (IAS 21)

The IFRIC has published a draft interpretation of IAS 21, *The Effects of Changes in Foreign Exchange Rates*. The proposed amendments are designed to correct for diversity in practice in circumstances in which consideration is received or paid prior to recognition of the related asset, expense or income.

IAS 21 requires that, when recording a foreign exchange transaction, the exchange rate in effect at the date of initial recognition of the transaction must be applied. When an entity pays or receives consideration in advance of recognizing the related asset, expense, or income it must recognize, as applicable, a non-monetary asset or liability reflecting its right to receive goods or services or its obligation to transfer goods or services. Once the goods and services have been received or delivered, the non-monetary asset or liability is derecognized when the related asset, expense, or income is recognized. The IFRIC reached the following consensuses:

- When foreign currency consideration is paid or received in advance for recognition of the related asset, expense, or income, the date of the transaction, and thus by applying the spot rate on such date, is the earlier of (1) the date of initial recognition of the nonmonetary asset or liability, and (2) the date that the asset, expense, or income, or a portion of it is recognized in the financial statements;
- If the transaction is recognized in stages, a date of the transaction should be established for each individual stage. If there is more than one date of the transaction, the spot exchange rate for each date should be applied to translate the applicable portion of the transaction;
- The related asset, expense, or income should represent the portion that is recognized upon derecognition of the nonmonetary prepayment asset or the nonmonetary deferred income liability, as appropriately determined under IFRS.

Note that the foregoing consensuses would not apply if the related asset, expense, or income is required to be recognized initially at fair value.

Comments must be received by January 19, 2016.

Exposure Draft – Remeasurement at a Plan Amendment, Curtailment or Settlement/Availability of a Refund of a Surplus from a Defined Benefit Plan

In June 2015, the IASB published an exposure draft in which it proposed to amend/clarify IAS 19, *Employee Benefits*, and IFRIC Interpretation 14, IAS 19 — *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

The proposed amendments are intended to clarify IAS 19 regarding the impact of a plan amendment, curtailment or settlement on the determination of current service cost and net interest. Under the current standard, an entity determines the actual cost of a plan amendment, curtailment or settlement based on the assumptions and fair value of the plan's assets as at the date of the event; however, the standard does not address how updating these data affect the determination of post-event current service cost and net interest.

As proposed, when the net defined benefit liability (asset) is remeasured when a plan amendment, curtailment, or settlement occurs: (1) the current service cost and the net interest for the period after the remeasurement would be determined using the same assumptions that were used for the remeasurement itself, and the net interest for the remaining period would be based on the remeasured net defined benefit liability (asset); and (2) the current service cost and the net interest in the current reporting period before a plan amendment, curtailment, or settlement would not be affected by, or included in, past service cost or any gain or loss on settlement.

Also, as proposed, in determining the availability of a refund from a defined benefit plan when other parties can wind up a plan or affect benefits for plan members without an entity's consent:

- The amount of the surplus that should be recognized as an asset on the basis of a future refund should not include amounts that other parties (e.g. the plan trustees) can use for other purposes (e.g. to enhance benefits for plan members) without the entity's consent;
- An assumed gradual settlement of the plan should not be used as justification for the recognition of an asset, if other parties can wind up the plan without the entity's consent;
- The power of the other parties to buy annuities as plan assets or make other investment decisions without changing the benefits for plan members would not affect the availability of a refund.

Comments were to be received by October 19, 2015.

Effective Date for Amendments to IFRS 10 and IAS 28

In August 2015, the IASB published an exposure draft that proposed to defer indefinitely the effective date of the narrow-scope amendments to IFRS 10 and IAS 28 (published in September 2014) concerning the determination of any gain or loss when assets are sold or contributed between the entity and an associate or joint venture in which it invests. The proposed deferral would be until such time as the IASB finalizes its research project on application of the equity method.

Comments were to be received by October 9, 2015.

Draft Practice Statement on Materiality

In October 2015, as part of its *Principles of Disclosure project*, the IASB published an invitation to comment on its draft practice statement on the application of materiality to general purpose financial statements.

The IASB document provides guidance regarding how materiality is defined for IFRS purposes and how it applies to the complete set of financial statements, including the accompanying notes. Major points in the proposed draft statement include the following:

- Materiality is defined in terms of omission or misstatement. Information is material if its omission or misstatement could influence the decisions of primary users of financial statements;
- Judgement should be applied to determine whether information could reasonably be expected to influence decisions that users make on the basis of those financial statements, given the specific circumstances of the entity and the way the information will be used by users of the financial statements;
- Materiality as a concept is not only quantitative, but also qualitative, and its assessment should be undertaken on both an individual and a collective basis. In addition, it consists not only in deciding whether to include or exclude information in the financial statements, but also in considering how the information should be presented, aggregated or disaggregated, both in the primary financial statements and in the accompanying notes;
- Disclosure should be made because of the nature of, and the circumstances surrounding, a particular transaction, event, or condition (e.g. in situations under which otherwise small amounts are deemed to be sensitive such as might be the case for related-party transactions, noncompliance with covenants, or influencing management's incentive compensation);
- In respect of specified required disclosures in an IFRS standard, they would not have to be provided if the information in them is not material, even if the applicable IFRS contains a list of so-called "minimum requirements".

Comments must be received by February 26, 2016.

Exposure draft – Recognition of Deferred Tax Assets for Unrealized Losses

The IASB has published an exposure draft that would amend IAS 12, *Income Taxes*, to clarify the recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The proposals would:

- Confirm that a decrease in the carrying amount of a fixed-rate debt instrument for which the principal is paid on maturity gives rise to a deductible temporary difference if the debt instrument is measured at fair value and if its tax base remains at cost (i.e. regardless of the fact that the holder expects to recover the carrying amount of the debt instrument by selling it or by collecting all of the contractual cash flows at maturity);
- Require that, when estimating probable future taxable profit, a comparison should be made of temporary differences with future taxable profit that excludes tax deductions resulting from the reversal of those deductible temporary differences;
- Clarify that (1) the assessment of whether to recognize the tax effect of a deductible temporary difference as a deferred tax asset must be made in combination with other deferred tax assets, and (2) if the tax law restricts the utilization of tax losses for specified types of income, the assessment must be made in combination with other deferred tax assets of the same type.

A final version should be published in early 2016.

Exposure Draft – Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value

In September 2014, the IASB published an exposure draft to propose amendments to IFRS 10, *Consolidated Financial Statements*, IFRS 27, *Separate Financial Statements*, and IAS 28, *Investments in Associates and Joint Ventures*, to confirm that the unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole rather than the individual financial instruments included within that investment, and that the fair value measurement of the investments should be the product of the quoted price multiplied by the quantity of financial instruments held. The exposure draft also proposes to align the fair value measurement of a quoted cash-generating unit with the fair value measurement of a quoted investment.

No effective date has been proposed. Comments were to be received by January 16, 2015. A final standard is planned for issuance in the second half of 2016.

Rate-regulated activities

In 2014, the IASB published interim standard IFRS 14, *Regulatory Deferral Accounts*, which applies only to first-time IFRS adopters.

Relevant provisions of IFRS 14 are as follows:

- It permits (but does not require) a first-time adopter to continue applying its previous GAAP for the recognition of “regulatory deferral account balances”, which is the neutral umbrella term for regulatory assets and regulatory liabilities;
- It allows an eligible entity to change its accounting policies for recognizing and measuring regulatory deferral account balances upon initial adoption of IFRS if, based on the criteria in IAS 8, *Accounting Policies, Changes in Estimates and Errors*, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant, to those needs;
- It requires presentation of regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances over the fiscal year as a separate line item in the statement of profit or loss and other comprehensive income;
- It requires information to be disclosed concerning (1) the type and nature of the rate-regulated activity and of the rate-setting process, (2) the basis for recognition or derecognition of regulatory deferral account balances, and (3) how the recovery of each class of regulatory deferral account debit balance or the reversal of each class of regulatory deferral account credit balance is affected by risk and uncertainty.

The effective date of IFRS 14 is January 1, 2016. Early application is permitted.

In addition to publishing this temporary standard, the IASB is continuing its work on the accounting treatment of rate-regulated activities. In September 2014, the IASB published a discussion paper titled *Reporting the Financial Effects of Rate Regulation* and issued an invitation to comment. This document seeks to identify what information about the financial effects of rate regulation is most relevant to financial statement users in their investment and lending decisions. Comments were to be received by January 15, 2015.

A joint outreach event was held in December 2014 to learn what information investors and analysts would like to see included in the financial statements of companies involved in rate-regulated activities.

The IASB is in the process of reviewing the comments received in response to its discussion paper and is planning to issue another working paper by the end of 2016.

Exposure Draft – Transfers of Investment Property

This exposure draft was issued in November 2015 to amend IAS 40, *Investment Property*. It provides clarifying guidance on whether a property under construction or development that was previously classified as inventory could be transferred to investment property when there is a change in its use. The proposed amendment states that a property may be transferred to or from investment property when, and only when, there is a change in its use (i.e. when the property meets, or ceases to meet, the definition of investment property) supported by evidence that a change in use has occurred. The amendments are also intended to re-characterize the list of examples of evidence that a change has occurred from exhaustive to non-exhaustive (however, no new examples would be added).

No specific effective date has been proposed for this exposure draft, although the revised guidance should be applied retrospectively.

Comments must be received by March 18, 2016. The IASB will decide in late 2016 the direction the project should take.

Annual improvements to IFRS

Annual Improvements to IFRS – 2012-2014 Cycle

In accordance with the 2012-2014 cycle of annual improvements, the following changes have been made and are effective for fiscal years beginning on or after January 1, 2016:

Changes in methods of disposal of non-current assets

The amendments to IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, clarify that a change in a method of disposal (e.g. reclassification of an asset from “held for sale” to “held for distribution to the owners” or vice versa) does not constitute a new disposal plan and does not modify the date of classification (e.g. the date the asset was originally classified as held for sale or held for distribution).

Servicing Contracts

Amendments were made to the disclosure requirements of IFRS 7, *Financial Instruments: Disclosures*, regarding a transferred financial asset with which an entity remains involved. The amendments clarify that, for purposes of the requirement to provide disclosures concerning continuing involvement in a transferred financial asset, a servicing contract that carries a fee could constitute continuing involvement, based on an analysis of the nature of the fee and the servicing arrangement.

Disclosure requirements for offsetting in interim financial statements

The amendments to IFRS 7 clarify that disclosures concerning offsetting of financial assets and financial liabilities are not required in condensed interim financial statements.

Discount rate for post-employment benefits

The amendments to IAS 19, *Employee Benefits*, clarify that the depth of the market for high-quality corporate bonds (or, in the absence of such bonds, for government bonds) used as a benchmark to determine the discount rate of post-employment benefits should be measured in the currency in which the benefits are paid, rather than in the currency on which the bonds reside.

Interim Financial Reporting

IAS 34, *Interim Financial Reporting*, states that if an entity does not provide certain disclosures “elsewhere” in its interim financial report, it must include them in the notes to its interim financial statements. The amendments to IAS 34 clarify that (1) required information must be included either in notes to the financial statements or incorporated by reference from somewhere within the larger interim report (e.g. management discussion), and (2) if incorporated by reference, the other information must be available to users on the same terms and at the same time as the interim financial statements themselves.

Annual improvements to IFRS – 2014-2016 Cycle

In accordance with the exposure draft *Annual Improvements to IFRSs – 2014-2016 Cycle*, the following amendments have been proposed:

Deletion of a number of short-term exemptions for first-time adopters of IFRS

IFRS 1, *First-time Adoption of International Financial Reporting Standards*, would be amended to delete short-term exemptions for first-time adopters of IFRS, either because they are relevant only for reporting periods that have now passed (or that will have passed when the proposed amendments become effective) or are deemed to have served their intended purpose. The following exemptions would therefore be deleted for first-time adopters:

- Relief from amendments to IFRS 7, *Financial Instruments: Disclosures*, concerning disclosures relating to liquidity risk, transfers of financial assets, and the offsetting of financial assets and liabilities;
- Relief concerning comparative disclosures under IAS 19, *Employee Benefits*, relating to the sensitivity of obligations under a defined benefit plan;
- Relief for a parent from assessing whether an entity is an investment entity on the basis of facts and circumstances that existed at the date of transition to IFRS (instead of requiring a retrospective assessment). This relief is considered unnecessary because, regardless of the date of assessment, an investment entity is required to measure investments in subsidiaries at fair value through profit or loss;
- Relief available to investment entities prior to the adoption of IFRS 13, *Fair Value Measurement*, allowing the use of previous fair values if such values represent amounts for which the investment could have been exchanged in an arm’s length transaction as at the measurement date.

Scope of disclosure requirements for interests in other entities

IFRS 12, *Disclosure of Interests in Other Entities*, would be amended to clarify that, except for the requirement to disclose the summary financial information of a subsidiary, associate or joint venture, the other disclosure requirements of IFRS 12 also apply to interests that are classified as held for sale, as held for distribution to owners, or as discontinued operations in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

Fair-value measurement of interests in listed subsidiaries, joint ventures and associates

As it now reads, IAS 28, *Investments in Associates and Joint Ventures*, provides an exemption from application of the equity method to interests in an associate or joint venture held directly by, or indirectly through, a venture capital organization, a mutual fund, a trust or a similar entity. Under this exemption, such interests may be measured at fair value through profit or loss, in accordance with IFRS 9, *Financial Instruments*. IAS 28 would be amended to clarify that the election to measure such investments under either the equity method or the fair value method in accordance with IFRS 9 may be made on an investment-by-investment basis, upon initial recognition. In addition, IAS 28 would be amended to clarify that such an election would also be available to a reporting entity that itself is, not an investment entity but holds an interest in an associate or a joint venture that is an investment entity.

Comments must be received by February 17, 2016. No specific date has been proposed for any of the foregoing proposed amendments.

Acronyms and Useful Links

Acronyms

AcSB – Accounting Standards Board (CPA Canada)

CPA Canada – Formerly CICA (Canadian Institute of Chartered Accountants)

CPA – Chartered Professional Accountants

PSAB – Public Sector Accounting Board

FASB – Financial Accounting Standards Board – USA

IFRS – International Financial Reporting Standards

IAS – International Accounting Standards

IASB – International Accounting Standards Board

IFRIC – International Financial Reporting Interpretations Committee

ASPE – Canadian Accounting Standards for Private Enterprises

NFPO – Not-for-Profit Organization

Part II of the CPA Canada Handbook – Accounting – ASPE Accounting Framework (“Part II”)

Part III of the CPA Canada Handbook – Accounting – NFPO Accounting Framework (“Part III”)

Part IV of the CPA Canada Handbook – Accounting – Pension Plans Accounting Framework (“Part IV”)

Useful Links

Websites

AcSB www.frascanada.ca

CPA Canada www.cpacanada.ca

FASB www.fasb.org

IASB www.iasb.org

Mazars in Canada www.mazars.ca

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