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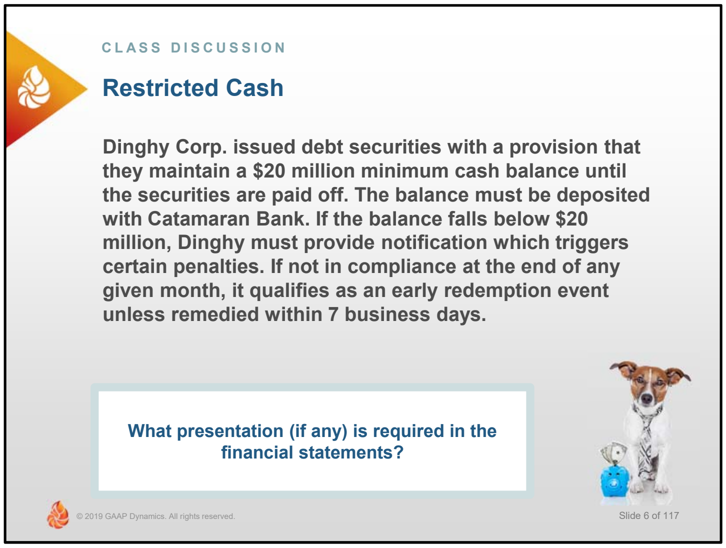
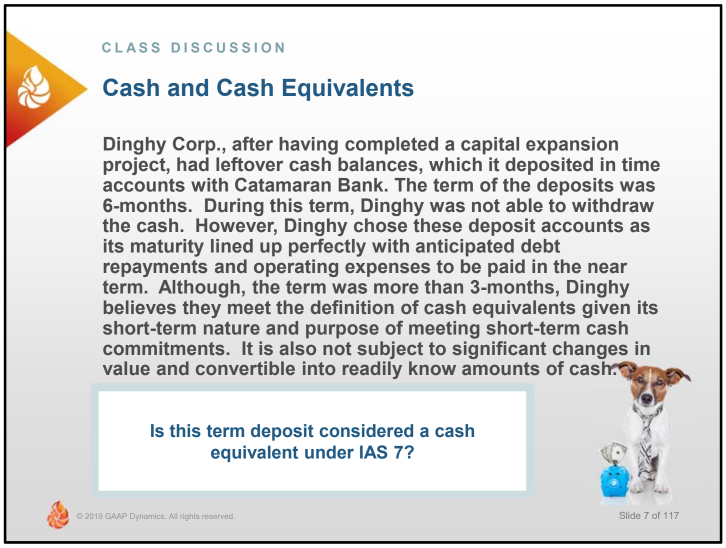


Note that the scenario and answer were adapted from Decision EECS/0118-02 of the 22nd extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. Some of the text below was taken directly from that enforcement decision. Text taken directly is show in italics and is referenced by paragraph.

What presentation (if any) is required in the financial statements?
Answer: The minimum cash balance of $20 million cannot be included in the "cash and cash equivalents" line item and should either be presented on a separate line or within another line of a similar nature. In addition, disclosures about the obligation to maintain a minimum cash balance must be provided.

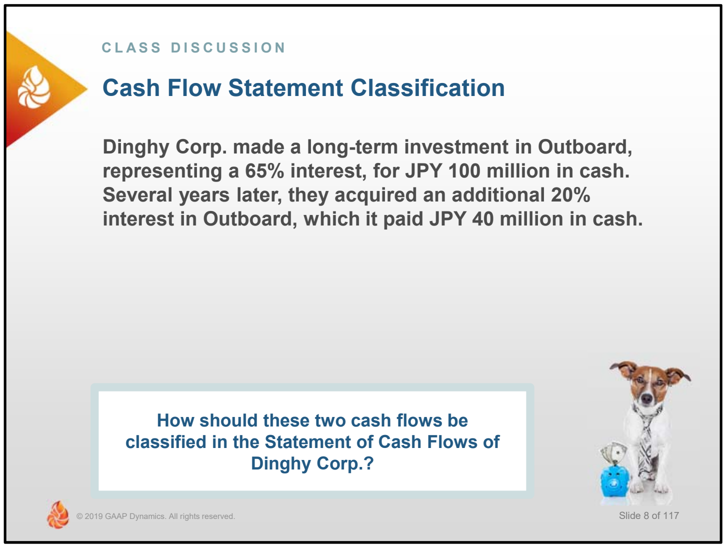
9. According to paragraph 48 of IAS 7, an entity must disclose the amount of significant cash and cash equivalents that are not available for use by the group. Furthermore, regardless of whether or not the minimum cash balance can be classified as cash and cash equivalents, in line with paragraph 31 of IFRS 7, the entity has to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments. In this respect the issuer has to provide information about liquidity restrictions imposed by the obligation to maintain a minimum cash balance.

10. Moreover, the enforcer concluded that, according to paragraph 7 of IAS 7, the issuer should have assessed whether the minimum cash balance was available to meet short-term cash commitments. In the case at hand, the contractual provisions of the perpetual notes oblige subsidiary A to maintain a minimum cash balance continuously until the notes are fully redeemed. Therefore, the minimum cash balance is not available to meet short-term commitments and thus is ineligible to be included in the line item 'cash and cash equivalents'.



Note that the scenario and answer were adapted from Decision EECS/0119-03 of the 23rd extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. Some of the text below was taken directly from that enforcement decision. Text taken directly is show in italics and is referenced by paragraph.

Question: Is this term deposit considered a cash equivalent under IAS 7?
Answer: No. The regulator noted that IAS 7.7 states that "an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition". Therefore, the enforcer considered that extending this to six months is an unwarranted departure from the sense of 'short term' in IAS 7.6-7. In particular, the enforcer considered that the lack of contractual right to early termination prevented classification of the deposits as cash equivalents.

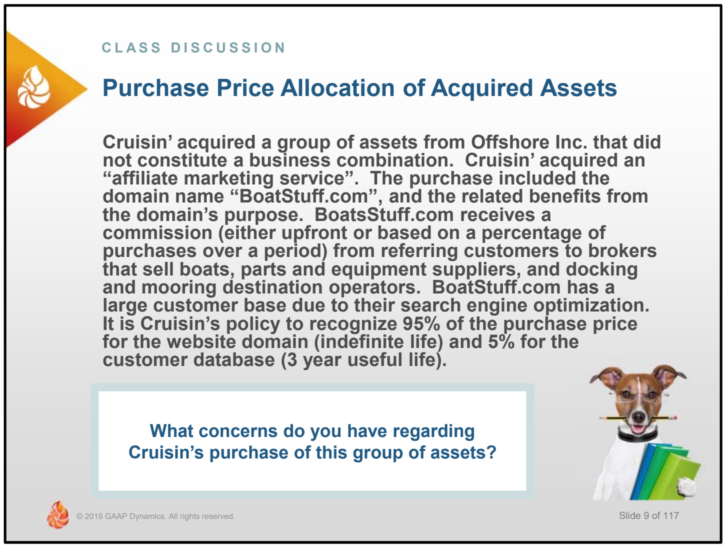


Note that the scenario and answer were adapted from Decision EECS/0119-01 of the 23rd extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. Some of the text below was taken directly from that enforcement decision. Text taken directly is show in italics and is referenced by paragraph.

Question: How should these two cash flows be classified in the Statement of Cash Flows of Dinghy Corp.?
Answer: The initial cash flow of JPY 100 million is a cash flow from INVESTING activities, but the additional JPY 40 million payment for more ownership is a cash flow from FINANCING activities.

IAS 7.42A requires cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control to be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity as defined in IFRS 10.

Furthermore, IAS 7.42B clarifies that as changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions, unless the subsidiary is held by an investment entity as defined in IFRS 10. Accordingly, the resulting cash flows are classified in the same way as other transactions with owners, i.e. as cash flows from financing activities.



Note that the scenario and answer were adapted from Decision EECS/0118-05 of the 22nd extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. Some of the text below was taken directly from that enforcement decision. Text taken directly is show in italics and is referenced by paragraph.

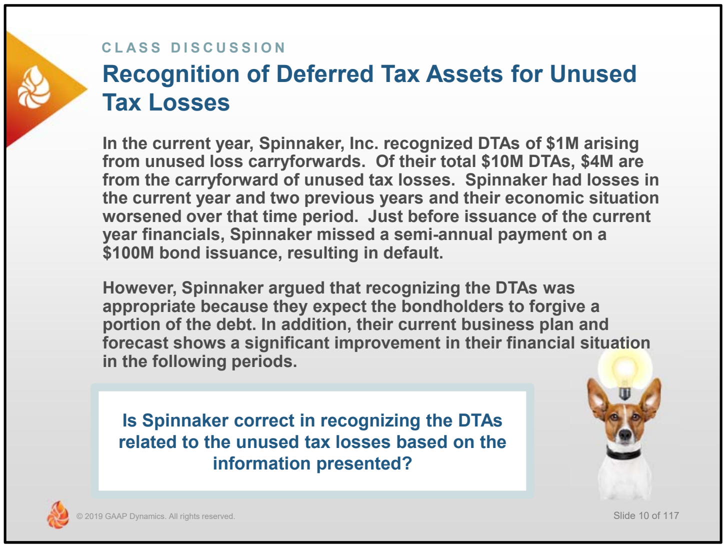
Question: What concerns do you have regarding Cruisin's purchase of this group of assets?
Answer: It appears as if Cruisin' did not identify ALL the intangible assets acquired from this purchase, the useful lives of the assets acquired may be called into question, and the allocation policy is likely not appropriate.

In an acquisition of a group of assets that does not constitute a business combination, all assets acquired, including intangible assets under IAS 38, must be identified and the purchase price of the group of assets must be allocated the purchase price based on relative fair value. In this case, Cruisin' acquired assets associated with a "affiliate marketing service". These assets included the domain name "BoatStuff.com". However, there is more value to the website other than just the domain name. The website content has been programmed in such a way that it has optimized its visibility with search engines (e.g. Google). This code and design can be replicated to other website Cruisin' holds, thus meeting the separability criterion under IAS 38 and meeting the definition of a separate intangible asset. Therefore, a case could be made for potentially two additional intangible assets: website content acquired programmed in HTML code using a publishing software AND the keyword and network architecture created by the developer, including its interrelation in the network hierarchy for the search engine optimization.

Regarding the customer database intangible asset, while this clearly has value and qualifies for an intangible asset, there are likely other customer-related intangibles from this acquisition. According to the case facts, commissions are earned either upfront or based on a percentage of purchases over a specified period. This infers that there are likely outstanding contracts with customers that were acquired at the time of purchase. These existing contracts that pay out commissions over time provide a present right to receive future cash flows and are separable because they arise from a contractual or other legal right (regardless of whether those rights are transferable or separable from the entity or from other rights and obligations).

The useful life of these intangible assets are all likely to be "definite" and NOT "indefinite" given the fact that they are all "technology"-related. *When determining the useful lives of the website content and the search engine optimisation, the enforcer noted that paragraphs 92 and 93 of IAS 38 indicate that given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, caution should be exercised when estimating the useful life of such intangible assets. Only when there are, after careful analysis of all the relevant factors, no foreseeable limits to the period over which the asset is expected to generate net cash inflows for the entity, should the asset be deemed to have an indefinite useful life. Considering the factors listed in paragraph 90 of IAS 38, especially subparagraphs c), d) and e), the enforcer concluded that both the website content and the intangible asset related to the search engine optimization do not have an indefinite useful life.*

Finally, the "policy" to allocate the purchase price based on a present percentage of allocation (in this case 95% to domain and 5% to customer database) is inappropriate. *While internet domain addresses on occasions can have significant value in itself, the enforcer deems this typically to be the case when the domain address itself is the brand or the trademark of the business which is not the case here*. Also a "policy" is not appropriate. Each intangible asset acquired should have its fair value determined based on the appropriate valuation techniques within IFRS 13 to perform a proper allocation rather than this "rule of thumb" approach taken in our example.

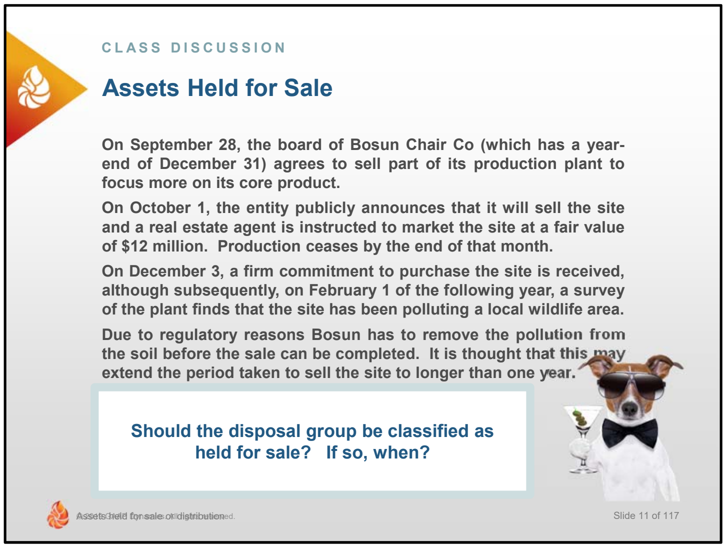


Note that the scenario and answer were adapted from Decision EECS/0117-11 of the 21st extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. Some of the text below was taken directly from that enforcement decision. Text taken directly is show in italics and is referenced by paragraph.

Is Spinnaker correct in recognizing the DTAs related to the unused tax losses based on the information presented?
Answer: No. The paragraphs below were taken from the enforcement decision and explain the rationale for this answer.

76. According to paragraph 34 of IAS 12, a deferred tax asset shall be recognised for carry-forward of unused tax losses to the extent that it is probable that future taxable profits will be available against which the unused tax losses can be utilised. Furthermore, paragraph 35 of IAS 12 sets out that the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, it recognises a deferred tax asset arising from unused tax losses only to the extent that there is convincing evidence that sufficient taxable profit will be available.

77. The enforcer determined that the issuer's expectation to successfully complete a renegotiation with the bondholders could not be considered convincing evidence, as it depended on the future decision of a third party, which outcome was uncertain. Moreover, the enforcer deemed that the significant uncertainty over whether the issuer was a going concern cast doubt on the ability of the issuer to fulfil its business plan. In fact, at the balance sheet date, the issuer was still negotiating the main features of future restructuring with local authorities, the realisation of which was highly uncertain. Therefore, the enforcer concluded that the issuer could not provide sufficient convincing evidence that sufficient taxable profit would be available against which the unused tax losses could be utilised by the company.

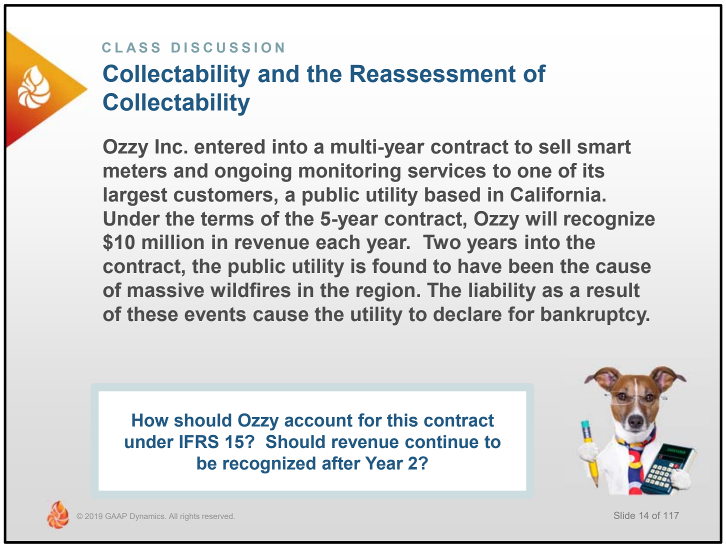


Question: Should the disposal group be classified as held for sale? If so, when?
Answer: Based on the limited facts shown and **ignoring the final two paragraphs**: the criteria would be met prior to the year-end. Based on the facts, **the disposal group would be classified as held for sale (HFS) on October 31,** as the last of the criteria (available for immediate sale) would only be met when all production has ceased. All of the other criteria would be met at this point. The entity can only classify the asset (or disposal group) as held for sale when **ALL** of the criteria are met. Thus, if production did not cease until after year-end, the asset would have to be classified as in use at year-end, as only three criteria would be met.

Follow-up question: What effect do the final two paragraphs have on the classification as held for sale?
Answer: **IFRS 5.9 does under certain circumstances allow an asset still to be classified as held for sale (HFS) even if a sale is not made within a year of classification.** IFRS 5.9 states that the reason for the sale taking greater than a year must be due to a circumstance that is beyond the entity's control. The standard provides examples of where such situations may occur in Appendix B. Appendix B1 (b) provides the example below:
an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:
(i) timely actions necessary to respond to the conditions have been taken, and
(ii) a favorable resolution of the delaying factors is expected.
Therefore, it could be argued that this disposal group would *still* meet the criteria for held for sale (HFS) at the year-end as the facts above would meet those shown within Appendix B1(b).
Documentation suggested to back up classification of a non-current asset/disposal group as held for sale (HFS) should include, but is not limited to, board minutes to indicate commitment by the appropriate level of management, although this in itself would not be sufficient to demonstrate commitment. Further evidence such as external communications to the marketplace by press releases, and/or engaging an agent to market the non-current asset/disposal group would be necessary.

Final follow-up question: Changing the facts slightly, assume that when the firm purchase commitment was signed on December 3, the survey had already been conducted and it was known that the pollution has to be removed before the sale can be completed. At that date it is though that this may extend the closing of the sale beyond one year. Can the asset still be classified as held for sale?
Answer: No. A similar scenario was provided in Decision EECS/0118-01 of the 22st extract from the EECS's Database of Enforcement. The EECS is part of the European Securities and Markets Authority. The following text was taken direct from the extract to explain the finding.

> *4. According to paragraph 8 of IFRS 5, in order for an asset to be classified as a non-current asset held for sale, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification. The standard only foresees an exemption to this rule if the sale is delayed by events or circumstances that are beyond the entity's control, which is not the case in this instance.*
>
> *5. The enforcer noted that, according to paragraph BC85 of IFRS 5, the criteria for classification as held for sale are fully converged to the US-GAAP's Statement of Financial Accounting Standards No. 144 (SFAS 144) Accounting for the Impairment or Disposal of Long-Lived Assets. Paragraph 30d of SFAS 144, which mirrors paragraph 8 of IFRS 5, sets out the condition in the following words: 'the sale of the asset is probable and transfer of the asset is expected to qualify for recognition as a completed sale, within one year'. It is thus clear that the one-year condition has to be fulfilled in every case.*

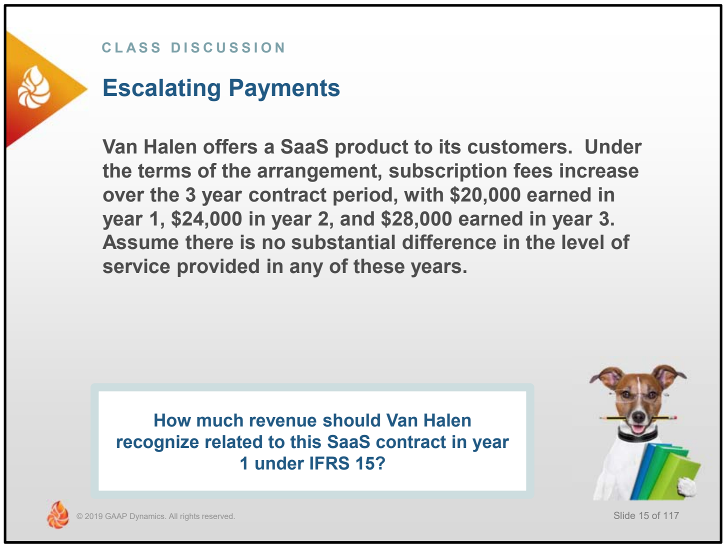


Question: How should Ozzy account for this contract under IFRS 15? Should revenue continue to be recognized after Year 2?
Answer: Given the significance in the change in the customer's credit quality, reassessment of the contract may be necessary, resulting in a contract between Ozzy and the customer no longer existing (in accounting terms under IFRS 15).

In accordance with IFRS 15.13, if a contract with a customer meets the criteria for "identify the contract" in IFRS 15.9 (Step 1) at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. How this reassessment criteria is to be applied was addressed by the Transition Resource Group (January 2015), that noted that the assessment of whether a significant change in facts and circumstances occurred will be situation-specific and will often be a matter of judgment.

When concerns arise regarding the collectibility of consideration, an entity will need to use judgment to determine whether those concerns arise from a significant change in facts and circumstances in the context of IFRS 15.13. Example 4 in IFRS 15 illustrates when a change in the customer's financial condition is so significant that a reassessment of if a contract with a customer exists is required. As a result of the reassessment, the entity determines that the collectibility criterion is not met and that the contract therefore fails step 1. Accordingly, the entity is precluded from recognizing additional revenue under the contract until the criteria in IFRS 15.15 are met or collectibility becomes probable. The entity also assesses any related contract assets or accounts receivable for impairment.

If an entity is required to reassess its contract because of a significant change in facts and circumstances, the criteria in Step 1 would only be evaluated in the context of the remaining goods or services that have yet to be provided. The reassessment would not affect any assets or revenue that has been recognized from satisfied performance obligations. However, assets would need to be evaluated for impairment under other applicable guidance.

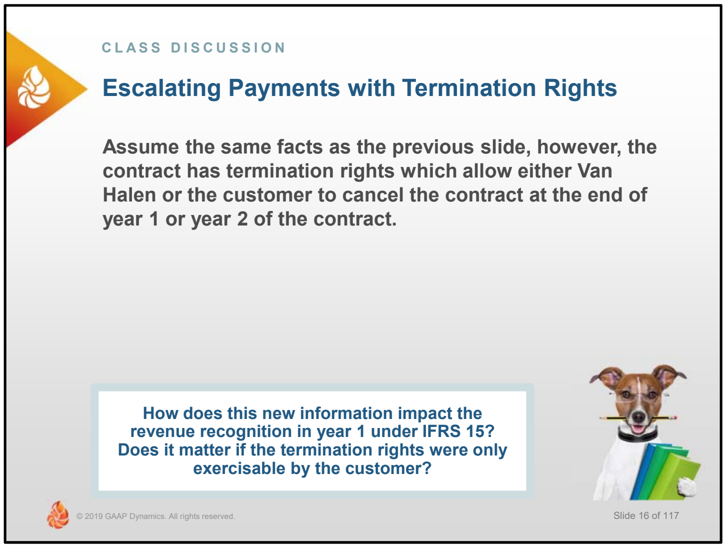


Question: How much revenue should Van Halen recognize related to this SaaS contract in year 1?
Answer: $24,000. IFRS 15 does NOT have the concept of deferring the recognition of contingent income as was the case under previous guidance. Instead, IFRS 15 determines the total consideration for the contract and allocates that transaction price over the period of time service is being performed. There is no "contingent cap" that needs to be considered. Instead, any income recognized in excess of cash received is recognized as a contract asset (essentially money earned for which Van Halen does not yet have the right to invoice/bill).

Year 1:

Dr. Cash	$20,000	
Dr. Contract asset	$4,000	
Cr. Revenue		$24,000

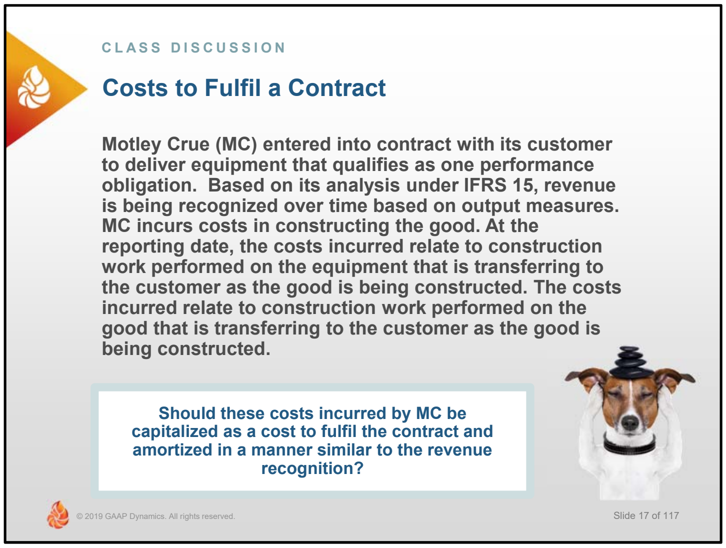
Of course, if the increase in fees from one year to the next was due to the fact that additional services were being performed in later years (e.g. more users), then perhaps this payment schedule would be more reflective of the revenue being earned.



Question: How does this new information impact the revenue recognition in year 1 under IFRS 15?
Answer: The termination rights result in the contract being treated as a one year contract with periods beyond one year not representing a contract until both parties agree to extend the contract. When both parties to the contract have the unilateral right to terminate the contract at the end of any designated period, a contract does not exist for periods beyond the then-current period in accordance with IFRS 15. Only upon commencement of the next service period, whereby enforceable rights and obligations exist for both parties until the next available termination date (i.e. the end of that period), does a contract for that period exist under IFRS 15.

Question: Does it matter if the termination rights were only exercisable by the customer?
Answer: No. When the customer only has a unilateral option to terminate a period-to-period contract, some enforceable rights and obligations continue to exist. That is, the customer has the unilateral right to continue to receive services and the entity an obligation to stand-ready to provide those services if elected by the customer for an optional period. However, because those services are optional to the customer, unless they provide the customer with a material right, there is no accounting by the entity for the customer option. The entity only accounts for the current period's services, which are not subject to cancellation, until the customer elects its option to obtain services for the next period (which includes by not cancelling the services), creating additional enforceable rights and obligations for the entity – i.e. the customer's decision not to cancel the services creates an enforceable obligation on the entity to provide the services and an enforceable right to receive payment for those services.

A contract under which services are provided period-to-period (e.g. month-to-month or year-to-year) unless cancelled by either party, and for which no penalty must be paid for cancellation (i.e. other than paying amounts due as a result of goods or services already transferred up to the termination date), is no different from a similar contract structured to require the parties to actively elect to renew the contract each period (e.g. place a new order, sign a new contract). This is regardless of whether both entities may cancel the contract or solely the customer. Consequently, an entity does not assume a contract period that extends beyond the then-current period. This is the case regardless of whether the contract has a stated contract period (e.g. a two-year stated term, but either entity can cancel the contract at the end of any month during that period for no penalty).



Question: Should these costs incurred by MC be capitalized as a cost to fulfil the contract and amortized in a manner similar to the revenue recognition?
Answer: No. As discussed in the IFRIC Agenda decision in June 2019, these costs relate to the entity's past performance and therefore do not generate or enhance resources of the MC that will be used in continuing to satisfy the performance obligation in the future. Therefore they do not qualify for asset recognition.

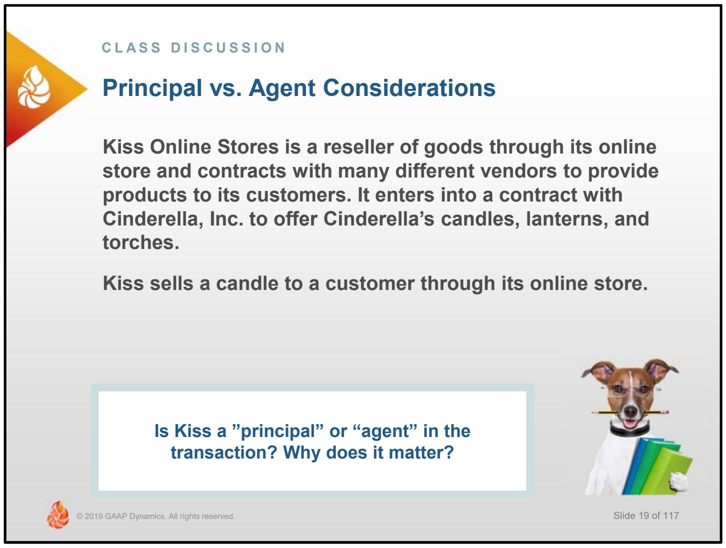
Per IFRIC June 2019 meeting:
The Committee received a request about the recognition of costs incurred to fulfil a contract as an entity satisfies a performance obligation in the contract over time. In the fact pattern described in the request, the entity (a) transfers control of a good over time (ie one (or more) of the criteria in paragraph 35 of IFRS 15 is met) and, therefore, satisfies a performance obligation and recognises revenue over time; and (b) measures progress towards complete satisfaction of the performance obligation using an output method applying paragraphs 39–43 of IFRS 15. The entity incurs costs in constructing the good. At the reporting date, the costs incurred relate to construction work performed on the good that is transferring to the customer as the good is being constructed.

The Committee first noted the principles and requirements in IFRS 15 relating to the measurement of progress towards complete satisfaction of a performance obligation satisfied over time. Paragraph 39 states that 'the objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer'. The Committee also observed that when evaluating whether to apply an output method to measure progress, paragraph B15 requires an entity to 'consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation'.

In considering the recognition of costs, the Committee noted that paragraph 98(c) of IFRS 15 requires an entity to recognise as expenses when incurred 'costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance)'.

The Committee observed that the costs of construction described in the request are costs that relate to the partially satisfied performance obligation in the contract—ie they are costs that relate to the entity's past performance. Those costs do not, therefore, generate or enhance resources of the entity that will be used in continuing to satisfy the performance obligation in the future (paragraph 95(b)). Consequently, those costs do not meet the criteria in paragraph 95 of IFRS 15 to be recognised as an asset.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine how to recognise costs incurred in fulfilling a contract in the fact pattern described in the request. Consequently, the Committee decided not to add the matter to its standard-setting agenda



Kiss sells a candle to a customer through its online store. Is it a "principal" or an "agent" in the transaction? Why does it matter?

Answer: **Let's start with the second question first (why does it matter?).** It matters because it impacts presentation in the income statement. Principals report revenue on a gross basis, meaning revenue and cost of sales separately. Agents report revenue on a net basis, meaning a single line item such as "commission income" or something to the effect. Therefore, determination of principal or agent is a significant consideration.

When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by the other party (that is, the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 606-10-25-19 through 25-22). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

So, is Kiss a principal or an agent?

The answer is, it depends. To determine the nature of its promise (IFRS 15.B34A), the entity should:

a) Identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party).

b) Assess whether it controls (as described in IFRS 15.33) each specified good or service before that good or service is transferred to the customer.

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (e.g., a subcontractor) to satisfy some or all of the performance obligation on its behalf.

When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

a) A good or another asset from the other party that it then transfers to the customer.

b) A right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.

c) A good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which include goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal) include, but are not limited to, the following:

a) The entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (i.e., primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.

b) The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (i.e., if the customer has a right of return). For example, if the entity obtains, or commits to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.

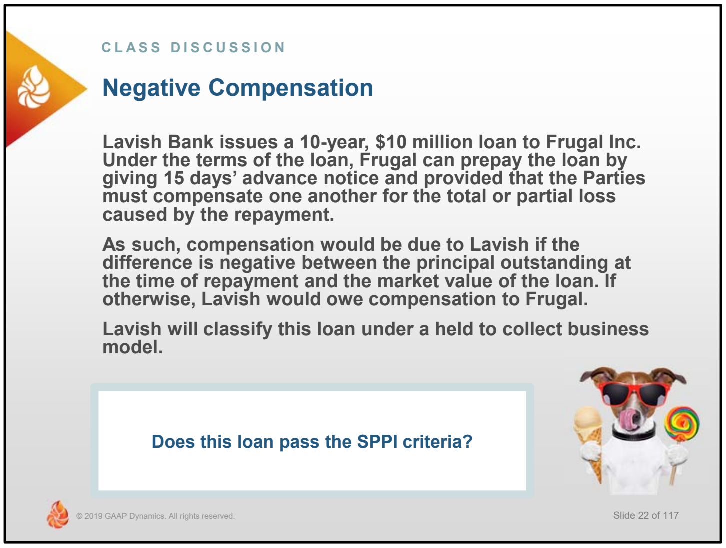
c) The entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

Our example is a "drop ship" type of arrangement which is common in certain industries, but presents particular challenges and judgement in determining whether the entity is acting as a principal or an agent. The SEC in the US has noted challenges such as this example when applying this guidance and has stated that the indicators of control should not be considered a checklist and judgment should be applied in determining the relevance of a particular indicator to a transaction.

Some considerations in making this judgment might be *(the facilitator should consider putting these on a flipchart)*:

- Does the entity actually take title to the goods at any point in the process?
- Who is responsible for the customer acceptance of the product (complaints, returns, etc.)?
- Can the retailer (Kiss in our example) return the product to the vendor (Cinderella) if it has been returned by the customer?
- Who sets the price for the good (or a floor/ceiling, if applicable)?
- Who is responsible for risk of loss or damage while in the retailer's store (if applicable)?
- Does the original vendor (Cinderella in our example) have a contractual right to take back goods delivered to the retailer? Has it ever exercised this right?
- Can the retailer move the goods between stores or within a store without permission (if applicable)?
- Does the retailer have any further obligation to the customer after submitting the customer's order to the vendor?
- Once the order has been placed, can the retailer direct the product to another party or prevent it from being delivered to the customer?

Understanding all of the terms and applying them to the basic indicators for principal vs. agent (which are summarized on the next slide) is key in making the determination. It is important to note that prior IFRS also had guidance on principle vs. agent, and it too required judgement. While the "spirit" of the guidance is similar, there may be differences in application between the old and the new standard that can result in different conclusions. The reason for this is that the new guidance focuses on control of the specified goods and services as an overarching principle for consideration.



Question: Does this loan pass the SPPI criteria?

Answer: Yes. The IASB issued a narrow scope amendment permitting certain prepayable financial assets with negative compensation to be measured at amortized cost or fair value through OCI (thus meeting the SPPI criteria).

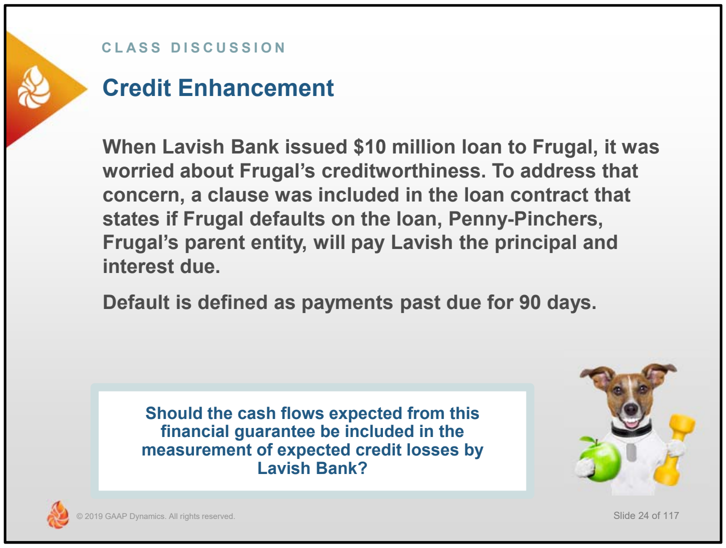
Instructor note: The next slide can be used to debrief this class discussion or can be used as a summary after the debrief.

This loan includes a prepayment feature that requires analysis under the SPPI criteria.

Remember, to meet the SPPI criterion, early termination of contract terms would have to substantially represent unpaid amounts of principal and interest which could include reasonable additional compensation for early termination of the contract. Under the facts presented, there is a potential scenario where the borrower could prepay the loan at an amount less than unpaid principal and interest owed as there could be a payment to the borrower from the lender (referred to as negative compensation).

Prior to the narrow scope amendment, most of the Interpretations Committee members held the view that a negative compensation prepayment option did not meet the SPPI requirements and would thus result in measurement at fair value through profit or loss (FVPL). Under a negative compensation scenario, the prepayment reflects a payment to the borrower from the lender (instead of compensation from the borrower to the lender even if the borrower chose to prepay). This was inconsistent with the previous IFRS 9 prepayment guidance which was generally interpreted to mean that the compensation or prepayment penalty must be paid by the party exercising the option to the other party.

The IASB choose to amend the guidance to permit financial assets with prepayment features that may result in reasonable negative compensation for the early termination of the contract to be eligible to be measured at amortized cost or at fair value through OCI because they noted that:
- Prepayment features which allow negative compensation do not introduce different contractual cash flow amounts from financial instruments with other prepayment features
- From a computation standpoint, the effective interest method can be applied
- The amortized cost method could provide useful information to users of financial statements

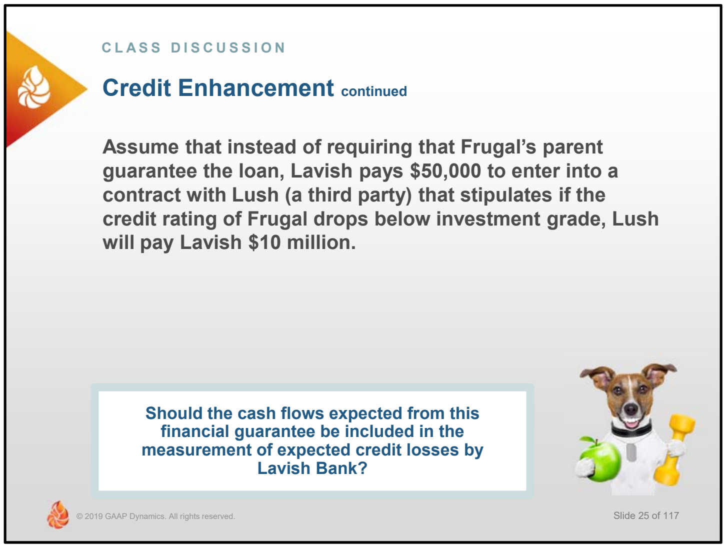


Question: Should the cash flow expected from this financial guarantee be included in the measurement of expected credit losses by Lavish Bank?

Answer: Yes.

Cash flows expected from a credit enhancement are included in the measurement of expected credit losses if the credit enhancement is both:

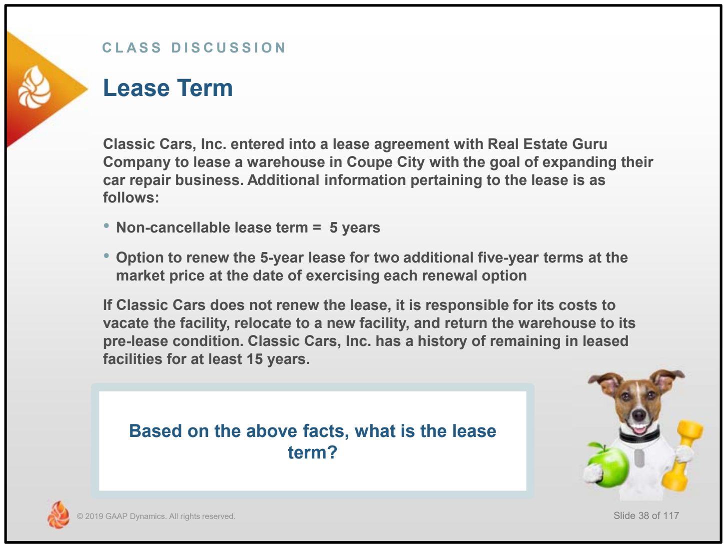
a. Part of the contractual terms; and
b. Not recognized separately by the entity.



Question: Should the cash flow expected from this financial guarantee be included in the measurement of expected credit losses by Lavish Bank?

Answer: No.

If a credit enhancement is required to be recognized separately by IFRS Standards, an entity CANNOT include the cash flows expected from it in the measurement of expected credit losses.



Question: Based on the above facts, what is the lease term?
Answer: It depends if Classic Cars is reasonably certain to exercise either of the five-year renewal options for the warehouse.

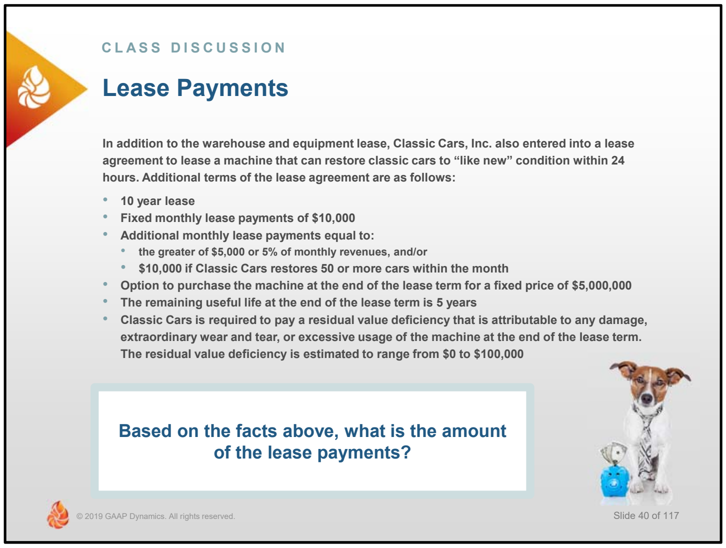
Economic factors, such as the requirement that Classic Cars is responsible for its costs to vacate the facility, relocate to a new facility, and return the warehouse to its pre-lease condition, should be considered when assessing whether it is reasonably certain to exercise the renewal options. Assuming that the costs are minimal and there is not an economic incentive, the lease term would be five years. Classic Cars should also take into account their history of staying in previous warehouses for at least 15 years; however, if there is not an economic incentive for Classic Cars to stay in the warehouse for greater than 5 years, then the lease term would only be 5 years.

In making an assessment of whether the lessee has an economic incentive to either exercise an option to extend a lease, or not exercise an option to terminate a lease, an entity would consider contract-based, asset-based, entity-based, and market-based factors. These factors would be considered together and the existence of any one factor would not necessarily indicate that a lessee has an economic incentive to exercise the option. Examples of factors to consider would include, but not be limited to:

- Contractual terms and conditions that apply to the optional periods as compared to current market rates, such as: The amount of non-contingent lease payments;
- The amount of variable lease payments or other contingent payments such as payments under termination penalties and residual value guarantees; and
- The terms and conditions of options (e.g., purchase options) that are exercisable after initial optional periods, including the exercise price of those options in relation to market rates;
- Whether leasehold improvements (if any) are expected to have significant economic value to the lessee when the option to extend or terminate the lease or purchase the asset becomes exercisable;
- Costs that would be incurred by the lessee to terminate the lease and sign a new lease, such as negotiation and relocation costs, costs of identifying another underlying asset suitable for the lessee's operations, or costs associated with returning the underlying asset in a specified condition and/or to a specified location; and
- The importance of the underlying asset to the lessee's operations, considering, for example, its location and whether it is a specialized asset.

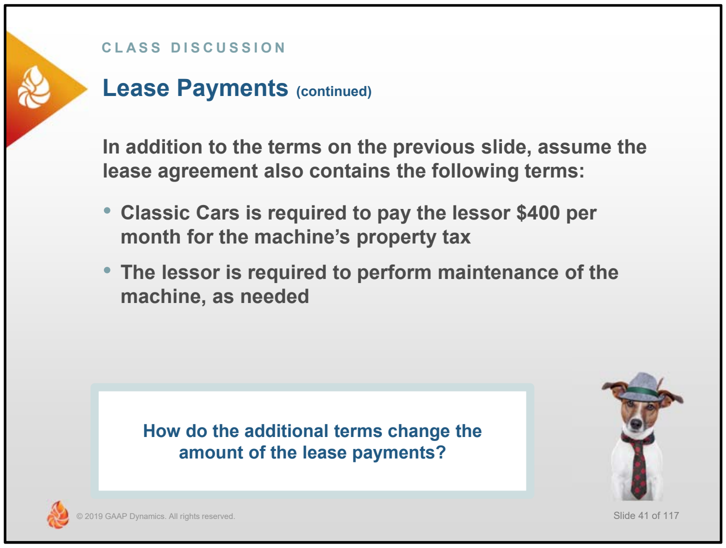
Follow-up question: What if Classic Cars spends $10 million to convert the warehouse into a state of the art auto body shop? Assume that those leasehold improvements have a useful life of 15 years. Do these additional facts change the lease term?
Answer: Yes, the additional facts change the lease term.

In the last example, we assumed that the cost for Classic Cars to vacate the warehouse, relocate to a new warehouse, and restore the warehouse to its original condition was minimal, and therefore, there is not an economic incentive. However, the new facts state that Classic Cars spends $10 million on leasehold improvements and the leasehold improvements have a useful life of 15 years. Due to the leasehold improvements having a useful life of 15 years, the leasehold improvements will have a significant economic value to Classic Cars at the end of both the five and ten years and Classic Cars will not be able to recover the value of the leasehold improvements if it vacates the warehouse. The construction of the significant leasehold improvements and the economic factors surrounding the improvements provides an economic reason for Classic Cars to stay in the warehouse for 15 years. Based on the facts in this example, it is reasonably certain that Classic Cars will exercise both of the renewal options and therefore, the lease term is 15 years.



Question: Based on the facts above, what is the amount of lease payments?
Answer: $1,800,000 (payments per lease agreement + in-substance lease payments). These lease payments will then be discounted to determine the present value of future lease payments in calculating the lease liability. *Please see the discussion of each item that may or may not be included in lease payments below.*

1. *Fixed payments = fixed payments per the lease agreement + in-substance lease payments – lease incentives*
   - *Fixed payments per the lease agreement:* The fixed monthly lease payment per the lease agreement is equal to $10,000. The total fixed lease payments are equal to $10,000 x 12 months x 10 years = $1,200,000.
   - *In-substance lease payments:* The additional monthly lease payment equal to the greater of $5,000 or 5% of monthly revenues is considered an in-substance lease payment. Although the amount appears to contain variability, the lease payment is unavoidable. Classic Cars know that it must pay *at least* an additional $5,000 each month. In this case the $5,000 per month payment would be included in the fixed lease payment amount. If the payment becomes greater than $5,000 due to 5% of monthly revenues being greater than $5,000 than the difference between the actual payment and the $5,000 would be included in the income statement in the period when the increase occurs. As such, the amount to be included in the lease payments is equal to $5,000 x 12 months x 10 years = $600,000.
   - *Lease incentives:* Based on the facts in the example, there are no lease incentives.
2. *Termination penalties:* Based on the facts in the example, there are no termination penalties that must be considered.
3. *Purchase options:* Classic Cars has the option to purchase the machine at the end of the lease for a fixed price of $5,000,000. Classic Cars needs to determine whether or not they are reasonably certain to exercise the option. When determining whether or not it is reasonably certain, Classic Cars should consider the economic factors. These economic factors are the same as the economic factors that were discussed when determining the lease term. Due to the large purchase price and the short useful life at the end of the lease term, it does not appear that it would be in Classic Car's best interest to purchase the machine at the end of the lease term. The price is fixed, as such, even if the market value of the machine is less, Classic Cars would still have to pay $5 million. However, Classic Cars would have to consider all of the information available to determine whether or not Classic Cars would exercise the purchase option. In this example, let's assume that there is not an economic incentive to exercise the purchase option and therefore, the $5,000,000 would not be included in the present value of lease payments. If there are additional facts and it is determined that there is an economic incentive, the purchase price option would be included in the lease payments.
4. *Variable lease payments:* We already discussed that the additional monthly lease payment equal to the greater of $5,000 or 5% of monthly revenues is considered an in-substance lease payment. However, what about the additional monthly payment of $10,000 if Classic Cars restores 50 or more cars within the month? This additional monthly payment is considered a variable lease payment but remember, that only variable lease payments that depend on an index or rate (for example, CPI or market interest rates) are included in the lease payments. This is because, for variable lease payments that are dependent on an index or rate, even though there is uncertainty about a change in that index or rate, these payments are unavoidable. However, based on the facts, the additional monthly payment of $10,000 is not based on an index or rate, it is based on the number of cars that are restored. As such, it is *excluded* from the lease payments. If Classic Cars does restore 50 or more cars in one month and is therefore required to pay the additional $10,000, the $10,000 would be expensed in the period that it is incurred. It does not impact the accounting for the ROU asset or lease liability.
5. *Residual value guarantees (RVG):* Although the residual value deficiency may appear to be a residual value guarantee, a provision requiring the lessee to make up a residual value deficiency that is attributable to damage, extraordinary wear and tear, or excessive usage is not a residual value guarantee. Amounts related to provisions such as these are considered a variable lease payment. As such, the amount would not be included in the amount of lease payments because it is not a variable lease payment that depends on an index or rate. If the lessee has to pay a residual value deficiency, the amount paid would be included as an expense in the P&L when the amount is paid by Classic Cars.
6. *Fees paid by SPEs:* Based on the facts in the example, there are no fees paid by SPEs.

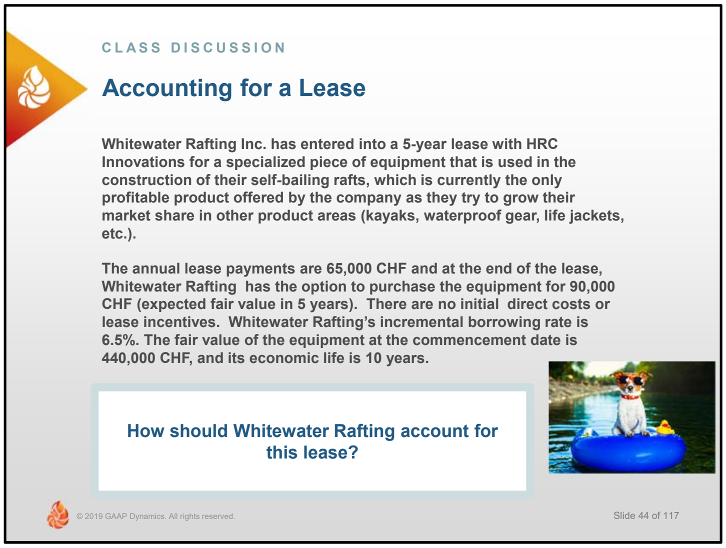


Question: How do the additional terms change the amount of the lease payments?
Answer: It depends if the two additional terms (the taxes and maintenance) are considered lease components or non-lease components. The maintenance of the machine would be considered a separate non-lease component because the lessor's activities (maintaining the machine) transfer services to Classic Cars. That is, Classic Cars receives a service from the lessor in the form of the maintenance activities that it would otherwise have to undertake itself or pay a third-party to perform maintenance of the machine. The machine property taxes are not considered components or non-lease components. Classic Cars' payment of the taxes solely represents an estimated reimbursement of the lessor's costs and do not represent payments for goods or services in addition to the right to use the machine. As such, there is no allocation of the consideration to these items. Therefore, this contract includes two components: a lease component (that is the right to use the machine) and a non-lease component (maintenance). The consideration in the contract of $1,800,000 is allocated between those two components (on a relative standalone price basis); the amount allocated to the lease component is the lease payments when accounting for the lease. (the amount that is discounted to determine the present value of the lease payments). However, Classic Cars could make an accounting policy election to use the practical expedient to not separate non-lease from lease components and would allocate the entire payments ($1,800,000) to the lease component (i.e. the lease payments under the contract). IFRS 16 requires entities to separate the lease components from the non-lease components in a contract.

Note: The practical expedient is for lessees only. It states that a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component.

Allocation Guidance:

- Lessor: IFRS 16 requires a lessor to allocate the consideration in a contract to lease components and non-lease components applying the requirements of IFRS 15 on allocating the transaction price to performance obligations.
- Lessee: A lessee should allocate the consideration in a contract to lease components and non-lease components based on the relative stand-alone price of each lease component and the aggregate stand-alone price of the non-lease components
    - Note: If the stand-alone prices are not readily available, the lessee can estimate the price while maximizing the use of observable information



Question: How should Whitewater Rafting account for this lease?

Whitewater Rafting recognizes the lease liability at the commencement date at 335,808 CHF (the present value of 5 payments of 65,000 CHF + the present value of the 90,000 CHF payment for the purchase option to be made at the end of Year 5, discounted at 6.5%). Because there are no initial direct costs, lease incentives, or other payments made to Lessor at or before the commencement date, Whitewater Rafting recognizes the right-of-use asset at the same amount as the lease liability.

Whitewater Rafting amortizes the right-of-use asset over the 10-year expected useful life of the equipment rather than over the lease term of 5 years, because Whitewater Rafting is reasonably certain to exercise the option to purchase the equipment.

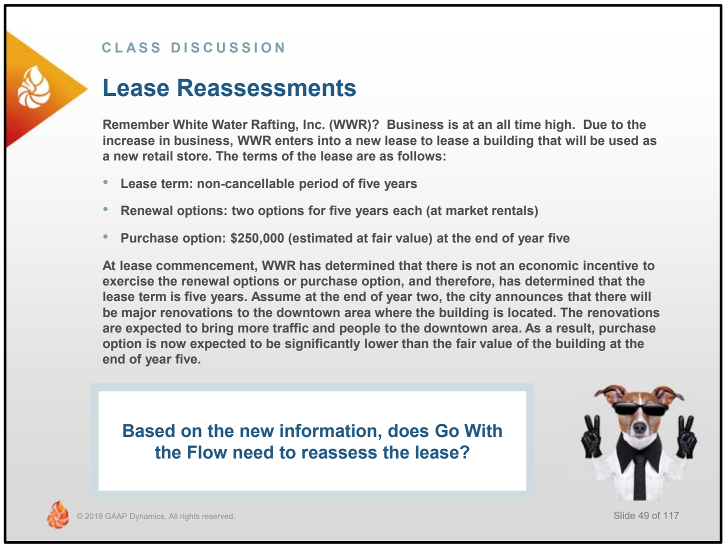
Assuming Whitewater Rafting depreciates the right-of-use asset on a straight-line basis, during the first year of the lease, Whitewater Rafting recognizes interest expense on the lease liability of 21,828 CHF (6.5% × 335,808) and amortization of the right-of-use asset of 33,581 CHF (335,808 ÷ 10).

At the end of Year 1, the right-of-use asset is 302,227 CHF (335,808 – 33,581), and the lease liability is 292,636 CHF (335,808 + 21,828 – 65,000).

At the end of Year 5, the carrying amount of the right-of-use asset is 167,903 CHF (335,808 – 33,581 × 5), and the remaining lease liability is 90,000 CHF, which is the amount of the purchase option. Whitewater Rafting exercises the option to purchase the equipment and settles the remaining lease liability. If the right-of-use asset was not previously presented together with property, plant, and equipment, Whitewater Rafting reclassifies the right-of-use asset to property, plant, and equipment and will apply ASC 360 to the equipment beginning on the date the purchase option is exercised.

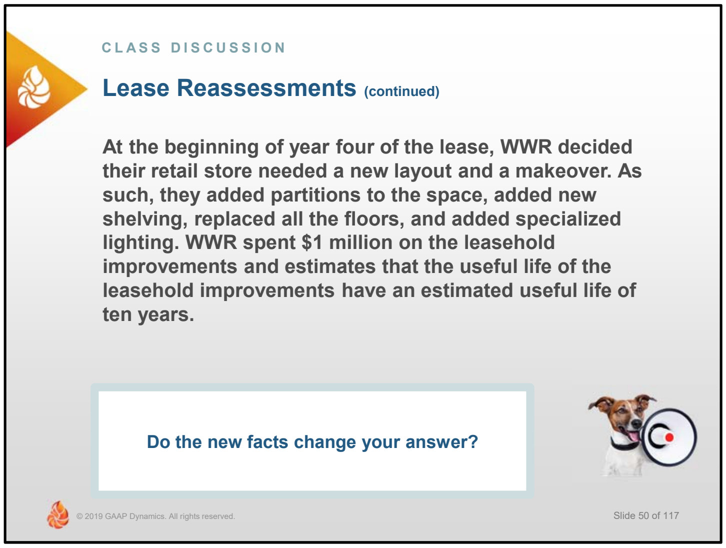
Follow-up question: Are there any other considerations (possibly indirect impacts) related to the initial and subsequent accounting?
Answer: YES! Both the initial and subsequent accounting under this new lease model will have income tax impacts. The ROU asset and lease liability that are recognized on the IFRS balance sheet will create temporary differences that will result in deferred tax assets (subject to consideration of recognition under IAS 12) and deferred tax liabilities. Those deferred tax amounts will change subsequently as the associated ROU asset and lease liability change.

In addition, the ROU asset must be considered for impairment under the "normal" asset impairment guidance in IAS 36.

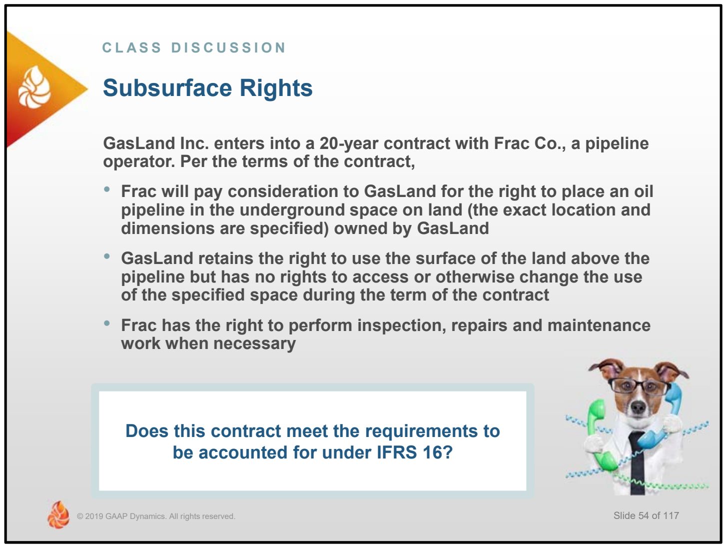


Question 1: Based on the new information, does Go With the Flow need to reassess the lease?
Answer 1: No. WWR does not need to reassess the lease.

Changes in *market-based factors* do not in isolation trigger the reassessment of a lessee option. This is because changes in market-based factors are usually out of the lessee's control. Under IFRS 16, the only time that a change in the likelihood of a renewal option being exercised is reassessed is upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term. This does not appear to meet that criteria.



Question: Do the new facts change your answer?
Answer: Yes. The leasehold improvements would be considered a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term.



Question: Does this contract meet the requirements to be accounted for under IFRS 16?

Answer: Yes, the contract contains a lease as defined in IFRS 16 and thus application of IFRS 16 is required.

This was a question submitted for consideration to the IFRS Interpretations Committee (IFRIC). Per their review:

An entity must consider whether the contract contains a lease as defined by IFRS 16.

Per IFRS 16, a lease is defined as a “contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”

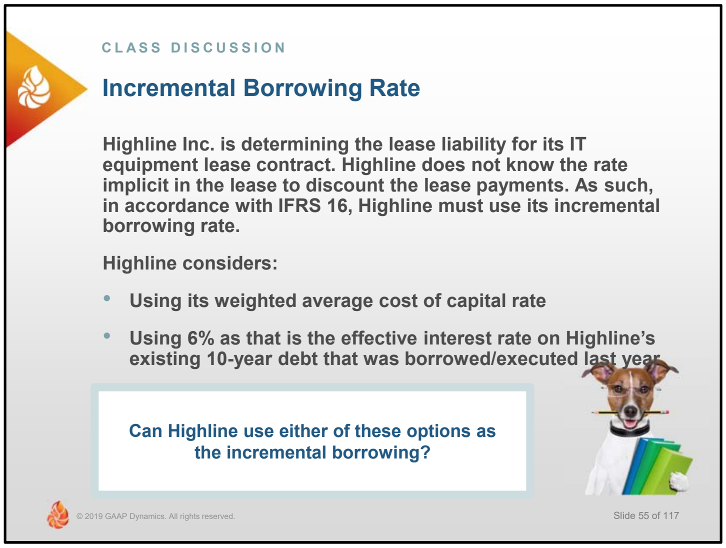
An entity should assess whether, throughout the period of use, the customer has both of the following
a. The right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use, and
b. The right to direct the use of the identified asset throughout the period of use

IFRIC concluded that the contract contains a lease as defined in IFRS 16, noting:

<u>Identified Asset</u>
- The specified underground space is physically distinct from the remainder of the land – the contract terms specify the exact location and dimensions – and that the space being underground does not itself affect whether it is an identified asset
- The landowner does not have substitution rights throughout the period of use

<u>Right to Obtain Substantially All the Economic Benefits from Use</u>
- The customer has the right to obtain substantially all the economic benefits from use of the specified underground space throughout the 20-year period.
- The customer has exclusive use of the specified underground space throughout the period of use

<u>Right to Direct the Use</u>
- The customer has the right to direct the use of the specified underground space throughout the period of use because:
  - How and for what purpose the specified underground space will be used is predetermined in the contract
  - The customer has the right to operate the specified underground space by the right to perform inspection, repairs and maintenance work, and
  - The customer makes all the decisions about the use of the specified underground space that can be made during the 20-period use



Question: Can Highline use either of these options as the incremental borrowing rate?

Answer:

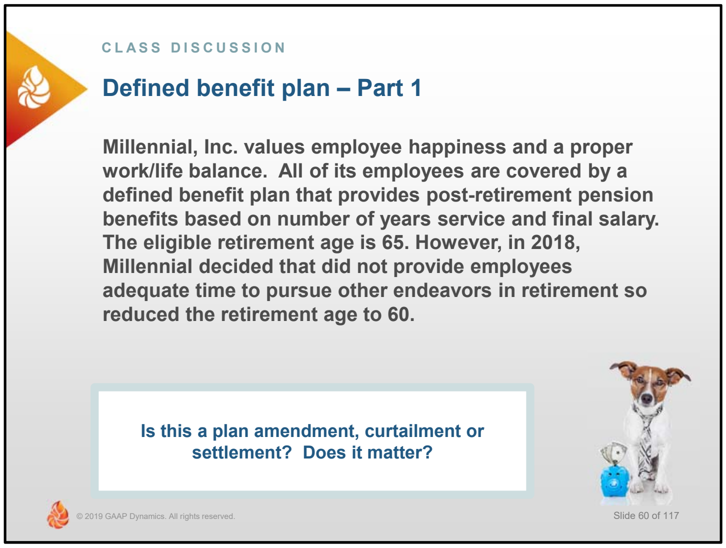
WACC: No
6% based on other direct borrowing: Most likely not.

IFRS 16 defines the lessee's incremental borrowing rate as the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar environment.

The incremental borrowing rate is specific to:
- The lessee
- The term of the arrangement
- The amount of the funds borrowed
- The nature and quality of the underlying asset (i.e. the security), and
- The economic environment, encompassing the jurisdiction, the currency and the date at which the lease is entered into

WACC
An entity's weighted average cost of capital (WACC) is a rate that incorporates both debt and equity. The incremental borrowing rate only considers borrowings. An entity's WACC is also not specific to the term, security and amount of the lease.

6% Based on Other Direct Borrowing
A lessee's incremental borrowing rate is lease specific (must take into account the terms and conditions of the lease). Depending upon the terms and conditions of the underlying asset and terms and conditions of the lease, the effective interest rate on direct borrowings may be a good starting point. But, a lessee would need to adjust that observable rate as needed. For example, adjustments may be needed for differences in credit risk or market conditions at the date of the lease versus the date of the borrowing.

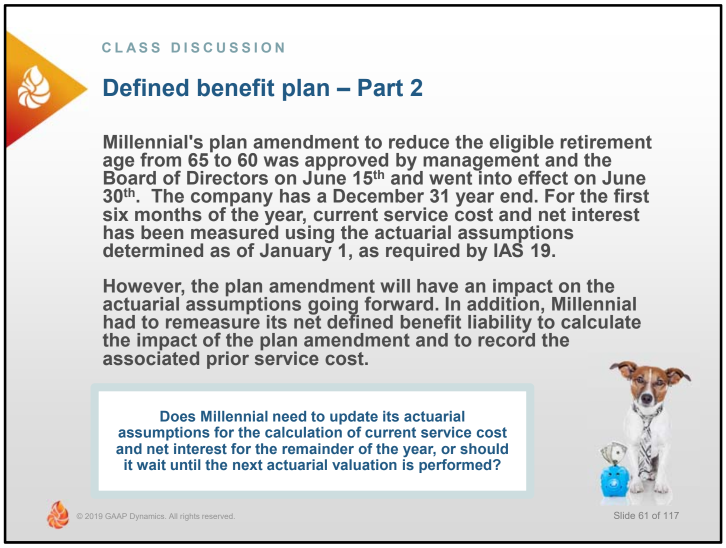


Is this a plan amendment, curtailment or settlement?
This is a plan amendment. A plan amendment occurs when an entity changes the benefits payable under an existing defined benefit plan. Examples might be changing the retirement age, changing the final salary on which the pension is based (adding/subtracting bonuses, going from final to average salary, changing the percent of final salary in the calculation, etc.), expanding the employee groups covered by the plans with retrospective application. The key is that a plan amendment is generally an change in the agreement between the entity and the employee. Plan amendments can be positive or negative.

A curtailment, on the other hand, occurs when there is a significant reduction by the entity in the number of employees covered by the plan. They can arise from isolated events (discontinuing an operation, closing a facility, etc.) or from terminating or suspending a plan. If the reduction is not significant then it is not a curtailment but is either just an actuarial gain/loss or a plan amendment.

A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a plan (other than "normal" payments under the plan). Examples of transactions that give rise to settlements are a one-off transfer of significant obligations of the entity under the plan to an insurance company through purchase of an insurance policy with no recourse to the entity or the termination of a plan that causes it to cease to exist (i.e. it is not just "frozen").

Why does it matter?
Well, it matters less than it once did. While it used to be quite different (prior to the revisions to IAS 19 that were effective in 2013), both plan amendments and curtailments give rise to past service cost which is accounted for as service cost in the P&L in the current period. Settlements also give rise to a gain or loss that is recognized as service cost in the P&L (although not considered "past" service cost). However, there may be differences in the timing of recognition between the three (i.e. when an event qualifies as a plan amendment, curtailment, or settlement might differ). There are also differences in disclosures.



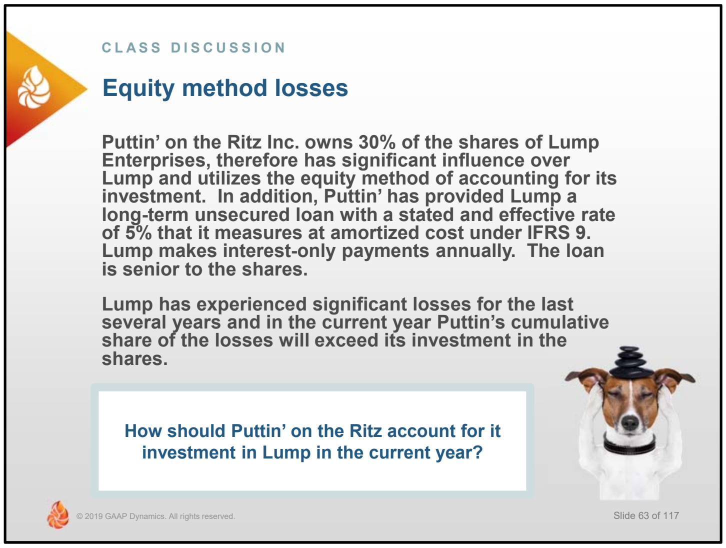
Does Millennial need to update its actuarial assumptions for the remainder of the year, or can it wait until the next actuarial valuation is performed?

It must update its actuarial assumptions for the remainder of the year. The IASB recently amended IAS 19 to clarify this requirement. This was necessary because IAS 19 prior to the amendments seemed to imply that an entity should not revise the assumptions for the calculation of current service cost and net interest cost, even if it remeasured the net defined benefit liability because of a plan amendment, curtailment or settlement. The implication was that the calculation should continue to b based on the assumptions as of the beginning of the annual reporting period. In its amendment, the IASB concluded that it is inappropriate to ignore the updated assumptions when determining the current service cost and net interest for the remainder of the annual reporting period.

Remember that generally, IAS 19 requires entities to measure current service cost and net interest using actuarial assumptions determined at the start of the annual reporting period. Those assumptions are generally not updated until the start of the next reporting period. However, under the recent revisions to IAS 19, when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity must:

- Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement using the updated actuarial assumptions used to remeasure the net defined benefit liability
- Determine net interest for remainder of period after the plan amendment, curtailment or settlement using the updated net defined benefit liability and the revised discount rate that was used to measure that updated net defined benefit liability.

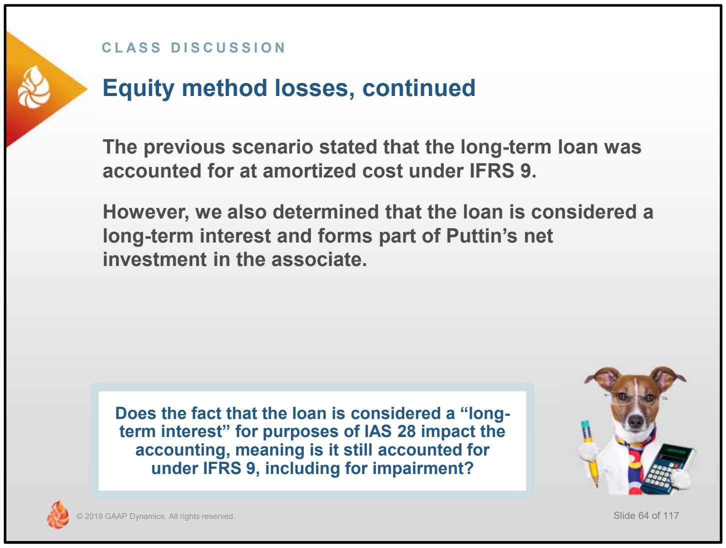
The amendments apply to plan amendments, curtailments or settlements that occur on or after January 1, 2019 with earlier application permitted.



How should Puttin' on the Ritz account for it investment in Lump in the current year?
Once Puttin' reduces its interest in Lump to zero, it does not absorb any further losses, unless the investor has incurred a legal or constructive obligation or made payments on behalf of the associate. If that is the case then a liability is recognized. However, that does not appear to be the fact pattern here. Therefore, once the interest has been reduced to zero, no further losses are recognized.

Follow-up question: But what does IAS 28 mean by "interest"?
Under IAS 28, "interest" is the carrying amount of the investment in the associate determined using the equity method *together with any long-term interest, that, in substance, form part of the entity'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, and extension of the entity's investment in that associate. Examples 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.
In this example, it appears that the L-T loan would be part of the "interest" in the associate.

Next follow-up question: So, what does that mean from an accounting standpoint?
That means that any losses recognized using the equity method in excess of the investors investment in "ordinary" shares are then applied to the other components of "interest" in the associate in the reverse order of their seniority (i.e. priority in liquidation). For our example, that means once the investment in the shares (i.e. the equity method investment) has been reduced to zero (in the current year based on the fact pattern), then remaining losses will be applied to the long-term loan. Only once it has also been reduced to zero does the investor stop recognizing any further losses.



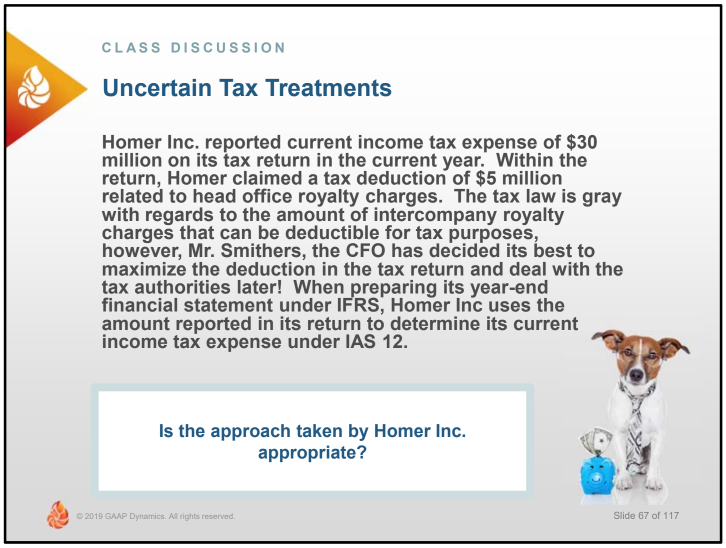
Does the fact that the loan is considered a "long-term interest" for purposes of IAS 28 impact the accounting, meaning is it still accounted for under IFRS 9, including for impairment?
The short answer is that the loan is still accounted for under IFRS 9 and is also measured for impairment under IFRS 9. This was recently clarified by the addition of paragraph 14A to IAS 28.

Specifically, the new paragraph 14A states "An entity also applies IFRS 9 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture (see paragraph 38). An entity applies IFRS 9 to such long0term interests before it applies paragraph 38 and paragraphs 40-43 of this Standard. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying this standard."

The has been diversity in practice regarding this accounting. The confusion arose from the fact that paragraph 14 of IAS 28 specifically states that "IFRS 9 does not apply to interest in associates and joint ventures accounted for using the equity method." If a long-term interest, other than the equity method interest, forms part of the overall interest in the associate because of paragraph 38 of IAS 28 (basically due to losses such as in our example), then some thought that meant the long-term interest was no longer within the scope of IFRS 9. Others thought that IFRS 9 still applied and the fact that the long-term interest was only mentioned in the context of sharing losses of the equity method investee did not change that.

The recent amendments to IAS 28 clarify that IFRS 9, including its impairment requirements, applies to long-term interests, such as the loan in our example. In addition, when applying IFRS 9 to the long-term interests, an entity does not take into account adjustments to their carrying amount required by IAS 28 (those that arise from the allocation of losses). Basically what the amendments are saying is that the long-term interest is measured under IFRS 9 (both "normal" accounting and for impairment purposes) without considering any write-down as a result of being included as a long-term interest under IAS 28. In essence, the two standards operate independently.

However, the interaction of these two standards can cause some tricky accounting. Therefore, the IASB provided a lengthy illustrated example illustrating the interaction of these two standards and showing the sequence in which they are applied. This sequence is also alluded to in paragraph 14A.



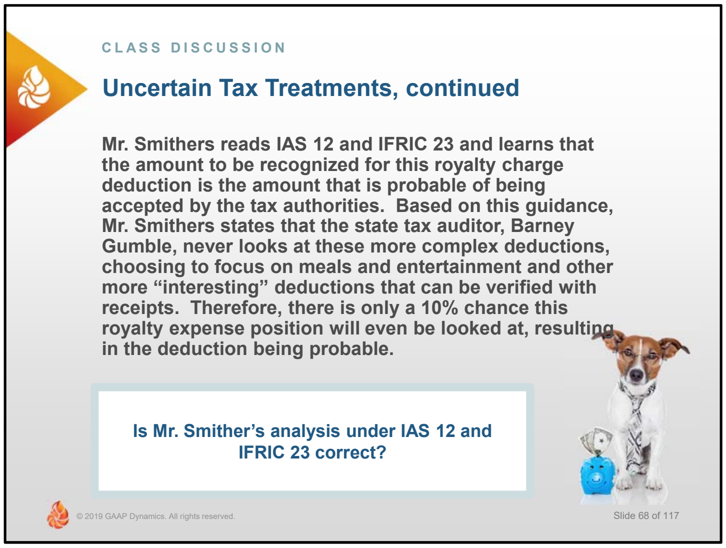
Question: Is the approach taken by Homer Inc. appropriate?

Answer: Probably not. The financial statements require the recognition of income tax expenses and obligations based on IAS 12, not the amount reported to the tax authorities. Therefore, Homer must determine the amount that is probable of being paid by the company as it relates to income taxes. This may not be the same as the amount self-reported to the tax authorities!

The tax deduction of $5 million related to head office royalty charges is an example of a uncertain tax treatment that must be assessed under IAS 12, and now IFRIC 23. An uncertain tax position may include various different positions taken when accounting for income taxes that may (or may not) ultimately be accepted by the tax authorities. These might include, but is not limited to:

- A decision not to file a tax return.
- Acceleration of a deduction that would be available in a later period.
- An allocation or a shift of income between jurisdictions.
- The characterization of income or a decision to exclude reporting taxable income in a tax return.
- A decision to classify a transaction, entity or other position in a tax return as tax exempt.

Homer must consider the likelihood of the tax authorities accepting this position and the ultimate amount that they will owe related to income taxes and report that amount at period end.

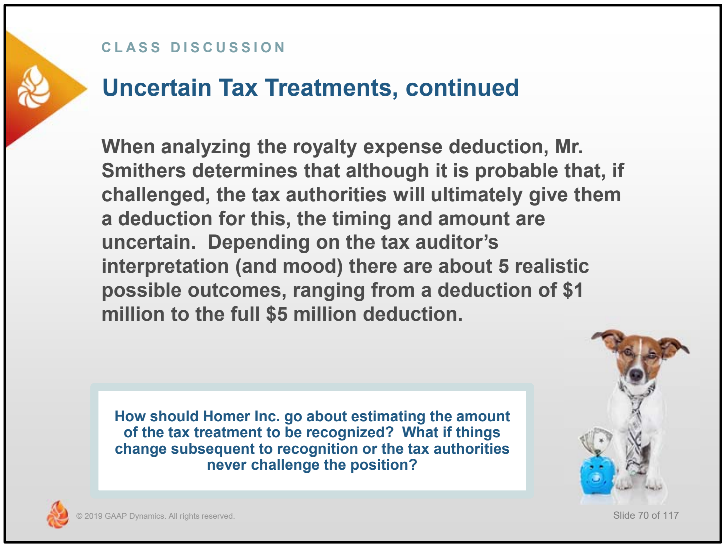


Question: Is Mr. Smither's analysis under IAS 12 and IFRIC 23 correct?

Answer: No. IFRIC 23 requires an assumption that the tax authorities will examine amounts it has a right to examine and that they will have full knowledge of all related information when making those examinations (IFRIC 23.8).

In making this decision, the IFRIC Basis of Conclusions noted that paragraphs 46–47 of IAS 12 require an entity to measure tax assets and liabilities based on tax laws that have been enacted or substantively enacted. In other words, the tax law creates a "legal obligation" and analysis of the amounts owed should be based on the merits of this law, not whether or not one will get away with disregarding this law.

The Basis of Conclusions also states that the IFRIC also noted that the assumption of examination by the taxation authority, in isolation, would not require an entity to reflect the effects of uncertainty. The threshold for reflecting the effects of uncertainty is whether it is probable that the taxation authority will accept an uncertain tax treatment. In other words, the recognition of uncertainty is not determined based on whether a taxation authority examines a tax treatment.



Question: How should Homer Inc. go about estimating the amount of the tax treatment to be recognized?
Answer: Judgement will likely need to be applied, but given that there are five different likely outcomes, an "expected value" approach (i.e. probability weighted average calculation) to determine the amount to be recognized is probably the best approach.

An entity shall consider whether it is probable that a taxation authority will accept an uncertain tax treatment. If an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. An entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which method the entity expects to better predict the resolution of the uncertainty:

a. the most likely amount—the single most likely amount in a range of possible outcomes. The most likely amount may better predict the resolution of the uncertainty if the possible outcomes are binary or are concentrated on one value.
b. the expected value—the sum of the probability-weighted amounts in a range of possible outcomes. The expected value may better predict the resolution of the uncertainty if there is a range of possible outcomes that are neither binary nor concentrated on one value.

If an uncertain tax treatment affects current tax and deferred tax (for example, if it affects both taxable profit used to determine current tax and tax bases used to determine deferred tax), an entity shall make consistent judgements and estimates for both current tax and deferred tax.

The IFRIC also confirmed in June 2019 tentative agenda decision, that presentation of uncertain tax treatments should follow IAS 12 as current or deferred income tax assets or liabilities and should be included in those accounts (not a separate line item).

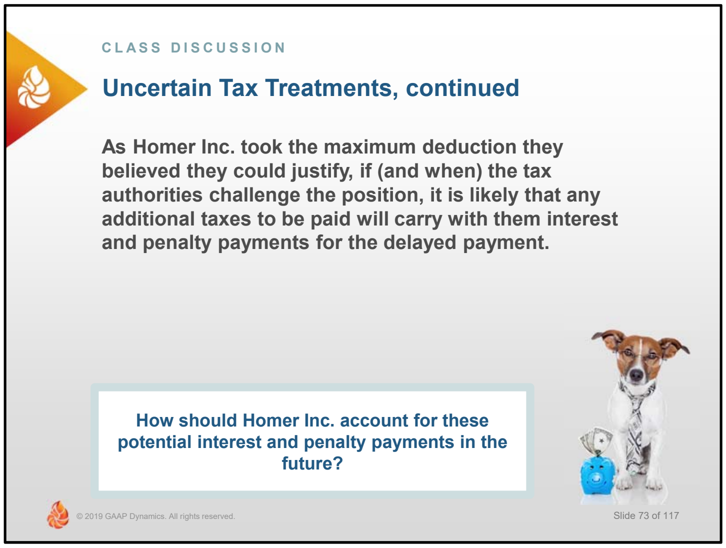
Question: What if things change subsequent to recognition or the tax authorities never challenge the position?
Answer: IFRIC 23 provides guidance on when to reassess uncertain tax treatments in the financial statements, including when these uncertainties go away.

An entity shall reassess a judgement or estimate required by IFRIC 23 if the facts and circumstances on which the judgement or estimate was based change or as a result of new information that affects the judgement or estimate. For example, a change in facts and circumstances might change an entity's conclusions about the acceptability of a tax treatment or the entity's estimate of the effect of uncertainty, or both. Examples of changes in facts and circumstances or new information that, depending on the circumstances, can result in the reassessment of a judgement or estimate required by IFRIC 23 include, but are not limited to, the following:

a. examinations or actions by a taxation authority. For example:
    - agreement or disagreement by the taxation authority with the
    - tax treatment or a similar tax treatment used by the entity;
    - information that the taxation authority has agreed or disagreed
    - with a similar tax treatment used by another entity; and
    - information about the amount received or paid to settle a similar tax treatment.
b. changes in rules established by a taxation authority.
c. the expiry of a taxation authority's right to examine or re-examine a tax treatment.

The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgements and estimates required by this Interpretation.

An entity shall reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. An entity shall apply IAS 10 *Events after the Reporting Period* to determine whether a change that occurs after the reporting period is an adjusting or non-adjusting event.

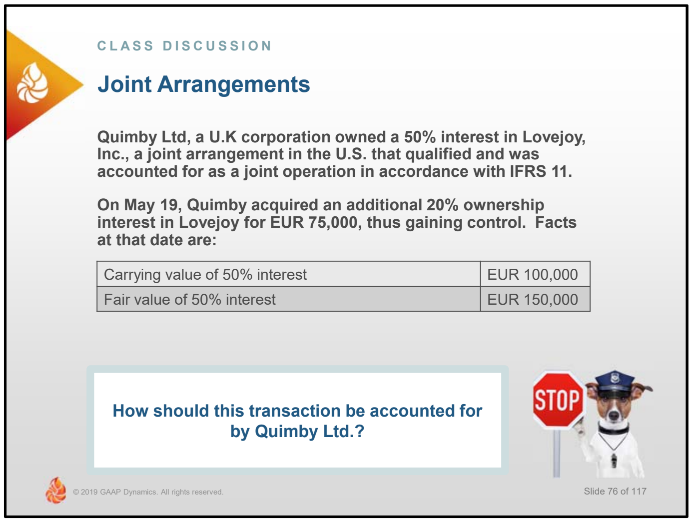


Question: How should Homer Inc. account for these potential interest and penalty payments in the future?

Answer: Neither IAS 12, IFRIC 23 nor IAS 37 specifically address interest and penalties for uncertain tax treatments. The IFRIC covered this issue in its September 2007 meeting, but decided not to add a project to formally address it in a standard or interpretation. Instead, in this meeting, they stated the following:

Entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties. Instead, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If an entity does not apply IAS 12 to a particular amount payable or receivable for interest and penalties, it applies IAS 37 to that amount. An entity discloses its judgement in this respect applying paragraph 122 of IAS 1 *Presentation of Financial Statements* if it is part of the entity's judgements that had the most significant effect on the amounts recognised in the financial statements.

Paragraph 79 of IAS 12 requires an entity to disclose the major components of tax expense (income); for each class of provision, paragraphs 84–85 of IAS 37 require a reconciliation of the carrying amount at the beginning and end of the reporting period as well as other information. Accordingly, regardless of whether an entity applies IAS 12 or IAS 37 when accounting for interest and penalties, the entity discloses information about those interest and penalties if it is material.



First a couple of reminders. IFRS 11 describes the accounting for joint arrangements. Joint arrangements can be joint ventures or joint operations and IFRS 11 provides guidance to determine this. The accounting is different, so this determination is critical. In this example we already know that we have a joint operation. In both its consolidated and separate financial statements, a joint operator recognizes its assets, liabilities, and transactions, including its share of those incurred jointly. These assets, liabilities, and transactions are accounted for in accordance with the relevant IFRSs. In this example, the “interest” constitutes the various assets and liabilities recognized as a result of the joint operation.

How should this transaction be accounted for by Quimby Ltd.?
As a business combination achieved in stages in accordance with paragraph 42 of IFRS 3. The annual improvements to IFRS (2015-2017 cycle) added paragraph 42A to IFRS 3 to clarify this. Paragraph 42A states:

> When a party to a joint arrangement (as defined in IFRS 11 Joint Arrangements) obtains control of a business that is a joint operation (as defined in IFRS 11), and had rights to the assets and obligations for the liabilities relating to that joint operation immediately before the acquisition date, the transaction is a business combination achieved in stages. The acquirer shall therefore apply the requirements for a business combination achieved in stages, including remeasuring its previously held interest in the joint operation in the manner described in paragraph 42. In doing so, the acquirer shall remeasure its entire previously held interest in the joint operation.

In a business combination achieved in stages, the acquirer remeasures its previously held interest in the acquiree at the acquisition date fair value. This “interest” is the entire interest, including the assets and liabilities it had recognized before obtaining control. Any resulting gain or loss is recognized in profit or loss or OCI, as appropriate.

For our example, the journal entries would be as follows:

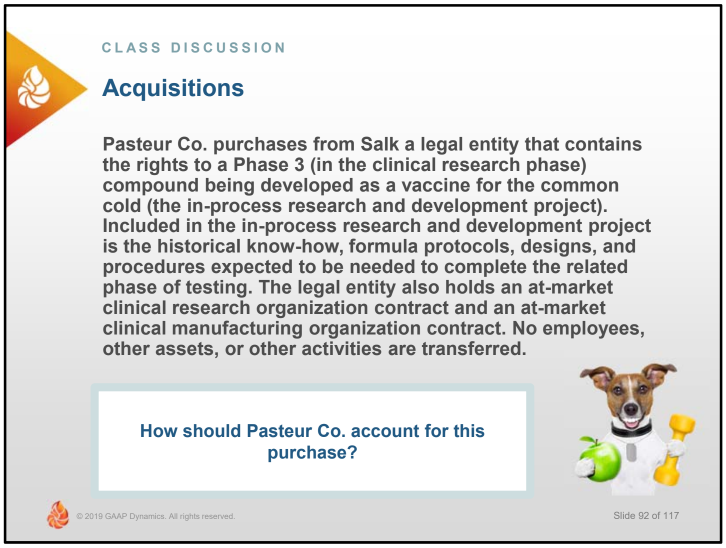
Restate its interest in Lovejoy at fair value.

Dr. Various assets and liabilities	50,000	
Cr. Gain on disposal		50,000

Record the purchase of the additional interest (“purchase price” is the FV of the existing interest plus the consideration paid for the additional interest.

Dr. Investment in subsidiary	225,000	
Cr. Various assets and liabilities		150,000
Cr. Cash		75,000

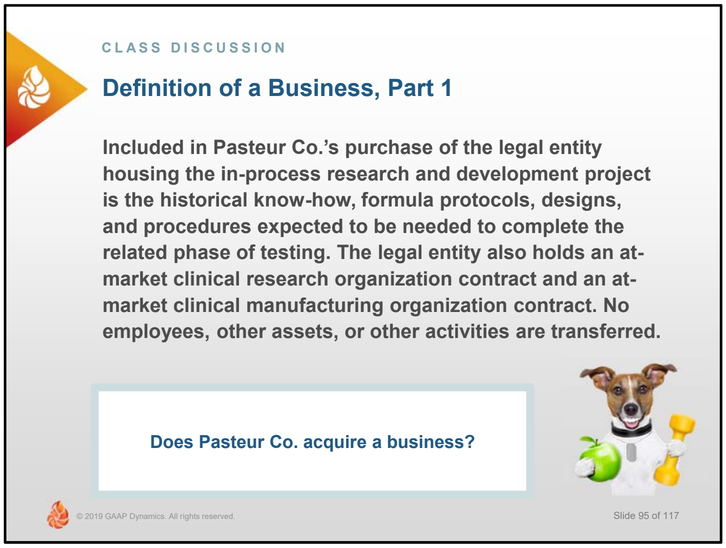
Important note: This annual improvement also provides guidance for a party who participates in a joint operation but did not have joint control, who then obtains joint control. In this case the previously held interest in the joint operation is not remeasured. The Board added paragraph B33CA to IFRS 11 to clarify this point.



Question: How should Pasteur Co. account for this purchase?
Answer: It depends. Not enough information has been provided to determine whether the purchase is of a "business" or a "group of assets".

Question: Why does it matter?
Answer: The accounting for an acquisition of a business is accounted for under IFRS 3 as a business combination, whereas the acquisition of a group of assets is not. The accounting differences are quite significant. See the following table:

Area	Business Combination	Asset Acquisition
Goodwill	Only arises in a business combination.	Do not recognize in an asset acquisition; allocate any excess consideration transferred over the fair value of the net assets acquired on a relative fair value basis to the identifiable net assets.
Bargain Purchase Amount	Recognize immediately in earnings as a gain.	Allocate on a relative fair value basis to identifiable assets and liabilities.
Measurement of assets and liabilities	Recognize at fair value.	Allocate purchase consideration based on relative fair values.
Contingent consideration	Recognize at its acquisition-date fair value.	Diversity in practice.
Transaction costs	Expense as incurred.	Add to the cost of the assets and IPR&D acquired.
Acquired in-process R&D (IPR&D) assets	Capitalize as an indefinite-lived intangible asset.	Expense unless the IPR&D has an alternative future use.



Question: Does Pasteur Co. acquire a business?
Answer: No. The set is not a business.

Optional Concentration Test:
- Pasteur concludes that the in-process research and development project is an identifiable intangible asset that would be accounted for as a single asset in a business combination
- Pasteur also qualitatively concludes that there is no fair value associated with the clinical research organization contract and the clinical manufacturing organization contract

The services are being provided at market rates and could be provided by multiple vendors in the marketplace.
- Therefore, all of the consideration in the transaction will be allocated to the in-process research and development project.

Substantially all of the fair value of the gross assets acquired is concentrated in the single in-process research and development asset.

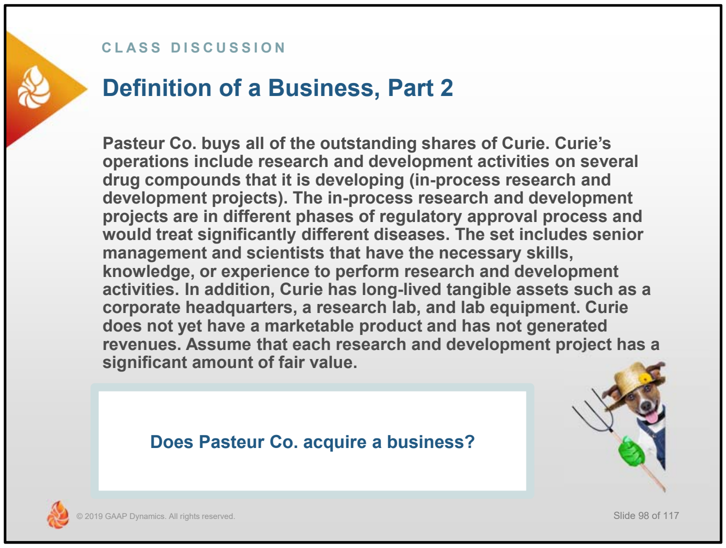
Result: The set is not a business.

In this example, the concentration test, if elected to be applied, results in the acquisition not meeting the definition of a business because substantially all of the fair value of the gross assets acquired relate to a single asset (group of assets) (i.e. the IPR&D related to the vaccine).

Note that the concentration test is optional and if the entity decided not to apply it, further analysis would need to be performed to determine if the acquisition was a business. We will discuss this assessment later in the module, however, the analysis would be as follows:

The acquisition must contain both an input and a "substantive" process. Because there are currently no outputs from the acquired set, IFRS 3 requires both of the following conditions to be met to be considered a substantive process:
- it is critical to the ability to develop or convert acquired inputs into outputs; and
- the inputs acquired include both an organized workforce and other inputs that the organized workforce could develop or convert into outputs

As it appears as if there is no acquisition of an acquired workforce, this transaction would not be considered a "business" under IFRS 3.



Question: Does Pasteur Co. acquire a business?
Answer: Yes. The set includes both inputs and substantive processes and is a business.

Optional Concentration Test:

- The identifiable assets in the set include multiple in-process research and development projects and tangible assets (the corporate headquarters, the research lab, and the lab equipment).

IFRS 3 clearly states that a combination of tangible and intangible assets is not considered "similar". Therefore the concentration test fails (i.e. must consider the definition of a business).

We need to consider further conditions or criteria.

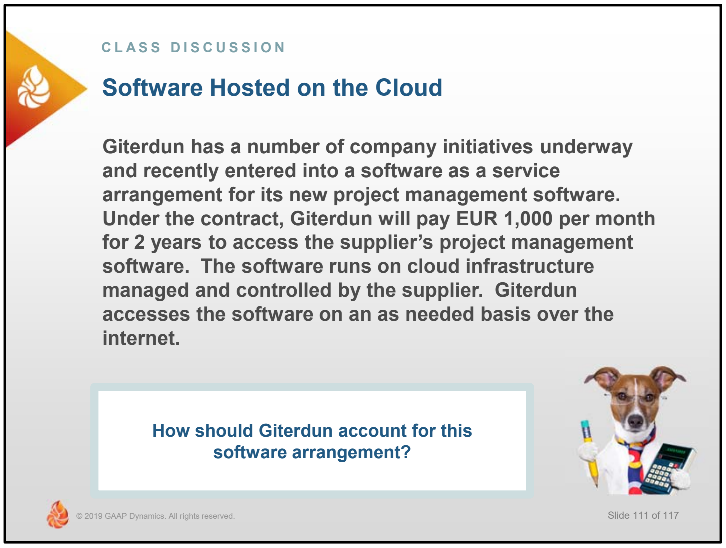
Applying definition of a business and specifically if a substantive process was acquired:

- The set does not have outputs

- Determine whether the set has both an input and a substantive process that together significantly contribute to the ability to create outputs

- The two criteria are met
  1. it is critical to the ability to develop or convert acquired inputs into outputs – Yes. The IPR&D is critical to being able to ultimately produce the drugs
  2. the inputs acquired include both an organized workforce and other inputs that the organized workforce could develop or convert into outputs – Yes. The scientists make up an organized workforce that has the necessary skills, knowledge, or experience to perform processes that is critical to the ability to develop the IPR&D into outputs (drugs).

Result: The set includes both inputs and substantive processes and is a business.



Issue based on IFRIC agenda decision published in March 2019

Question: How should Giterdun account this software arrangement?
Answer: Probably as a service contract that expenses the cost of the service as it is used (i.e. expense EUR 1,000 per month for 2 years, with a prepaid expense asset for the upfront payment).

In order to recognize the software arrangement as an asset, the arrangement must qualify as a software lease (under IFRS 16) or an intangible asset (under IAS 38).

Per IFRIC Agenda Decision (Mar 2019):
Software lease:
IFRS 16 Leases defines a lease as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. Paragraphs 9 and B9 of IFRS 16 explain that a contract conveys the right to use an asset if, throughout the period of use, the customer has both:
a. the right to obtain substantially all the economic benefits from use of the asset (an identified asset); and
b. the right to direct the use of that asset.

The application guidance in IFRS 16 specifies that a customer generally has the right to direct the use of an asset by having decision-making rights to change how and for what purpose the asset is used throughout the period of use. Accordingly, in a contract that contains a lease the supplier has given up those decision-making rights and transferred them to the customer at the lease commencement date.

The Committee observed that a right to receive future access to the supplier's software running on the supplier's cloud infrastructure does not in itself give the customer any decision-making rights about how and for what purpose the software is used—the supplier would have those rights by, for example, deciding how and when to update or reconfigure the software, or deciding on which hardware (or infrastructure) the software will run. Accordingly, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the contract does not contain a software lease.

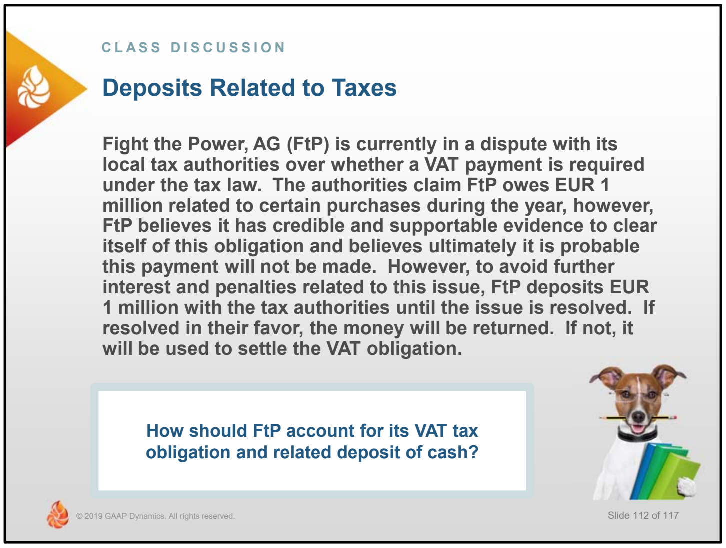
Intangible asset:
IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 specifies that an entity controls an intangible asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The Committee observed that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date. A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Consequently, the Committee concluded that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract. The customer receives the service—the access to the software—over the contract term. If the customer pays the supplier before it receives the service, that prepayment gives the customer a right to future service and is an asset for the customer.

Follow-up question: Assume Giterdun incurred a number of upfront costs to integrate the software as a service with other programs in its software infrastructure. How are these direct costs essential to making the software functional with the company's IT infrastructure accounted for?

Answer: IFRS is not explicit on this, however, if the arrangement is considered a service contract with no related software asset, the costs are likely expensed as incurred. Note, however, that US GAAP recently amended its guidance to enable these costs to be capitalized and expensed (as service costs) over the contract period, similar to the service payments to the supplier.



Issue based on IFRIC agenda decision published in January 2019

Question: how should FtP account for its VAT tax obligation and related deposit of cash?
Answer: IAS 37 is applicable to the VAT obligation (contingent liability) and IFRS is silent with regards to the deposit, however, the IFRS Framework provides adequate guidance to properly account for it.

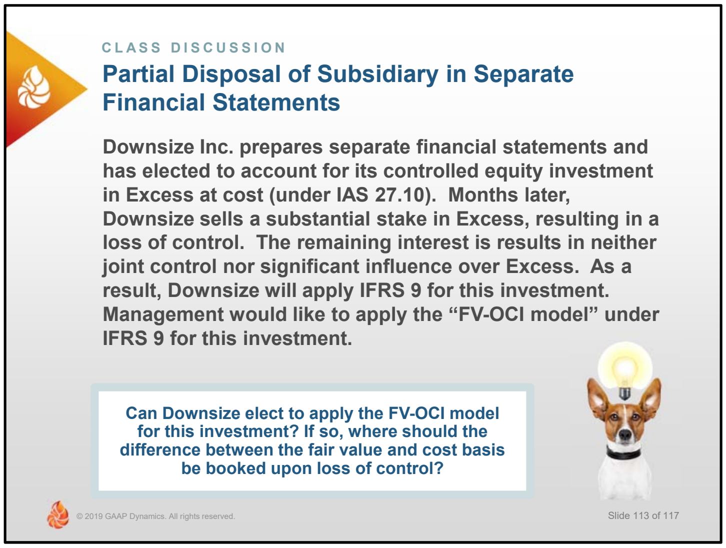
VAT obligation:
As the tax relates to VAT and not income, IAS 12 is not applicable as it only addresses income taxes. Instead, IAS 37 is applied for the contingent liability related to the VAT. When applying IAS 37, taking account of all available evidence, the preparer of FtP's financial statements judges it probable that the entity will not be required to pay the tax—it is more likely than not that the dispute will be resolved in it's favor. Therefore, the entity discloses a contingent liability and does not recognize a liability.

Deposit:
To avoid possible penalties, FtP has deposited the disputed amount (EUR 1 million) with the tax authority. Upon resolution of the dispute, the tax authority will be required to either refund the tax deposit to FtP (if the dispute is resolved in the entity's favor) or use the deposit to settle FtP's liability (if the dispute is resolved in the tax authority's favor).

The IFRIC observed that if the tax deposit gives rise to an asset, that asset may not be clearly within the scope of any IFRS Standard. Furthermore, they concluded that no IFRS Standard deals with issues similar or related to the issue that arises in assessing whether the right arising from the tax deposit meets the definition of an asset. Accordingly, applying paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the IFRIC referred to the definition of an asset in the Conceptual Framework. The IFRIC concluded that the right arising from the tax deposit meets the definition of an asset. The tax deposit gives the entity a ***right to obtain future economic benefits***, either by receiving a cash refund or by using the payment to settle the tax liability. The nature of the tax deposit—whether voluntary or required—does not affect this right and therefore does not affect the conclusion that there is an asset. The right is not a contingent asset as defined by IAS 37 because it is an asset, and not a possible asset, of the entity.

Consequently, the IFRIC concluded that in the fact pattern described in the request the entity has an asset when it makes the tax deposit to the tax authority.

In the absence of a Standard that specifically applies to the asset, an entity applies paragraphs 10–11 of IAS 8 in developing and applying an accounting policy for the asset. The entity's management uses its judgement in developing and applying a policy that results in information that is relevant to the economic decision-making needs of users of financial statements and reliable. The IFRIC noted that the issues that need to be addressed in developing and applying an accounting policy for the tax deposit may be ***similar or related to those that arise for the recognition, measurement, presentation and disclosure of monetary assets***. If this is the case, the entity's management would refer to requirements in IFRS Standards dealing with those issues for monetary assets.



Issue based on IFRIC agenda decision published in January 2019

Question: Can Downsize elect to apply the FV-OCI model for this investment?
Answer: Yes. Although the investment is not "new" to the entity, it is "new" in the sense that IFRS 9 is being applied for the first time to it. Therefore, this election is allowed to be made to apply the FV-OCI model.

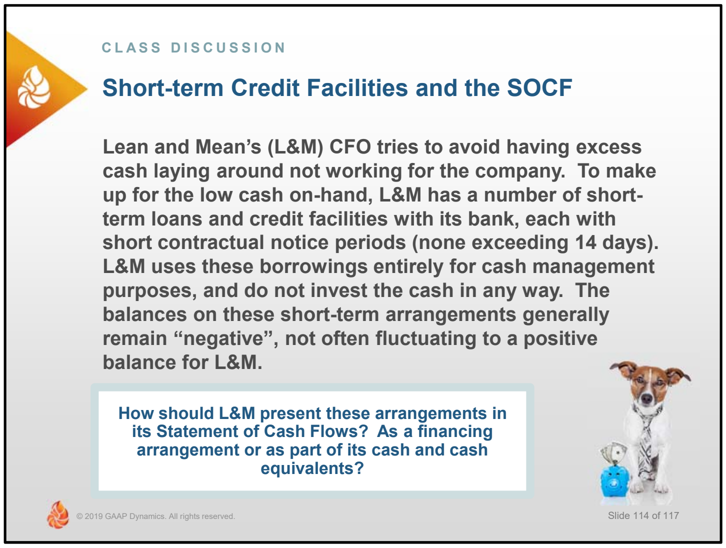
IAS 27.9 requires an entity to apply all applicable IFRS Standards in preparing its separate financial statements, except when accounting for investments in subsidiaries, associates and joint ventures to which IAS 27.10 applies. After the partial disposal transaction, Excess is not a subsidiary, associate or joint venture of the entity. Accordingly, Downsize applies IFRS 9 for the first time in accounting for its retained interest in the investee. The IFRIC observed that the presentation election in paragraph 4.1.4 of IFRS 9 applies at initial recognition of an investment in an equity instrument. An investment in an equity instrument within the scope of IFRS 9 is eligible for the election if it is neither held for trading nor contingent consideration recognized by an acquirer in a business combination to which IFRS 3 applies.

Assuming the retained interest is not held for trading, the IFRIC concluded that (a) the retained interest is eligible for the presentation election in paragraph 4.1.4 of IFRS 9, and (b) the entity would make this presentation election when it first applies IFRS 9 to the retained interest (ie at the date of losing control of Excess).

Question: If so, where should the difference between the fair value and cost basis be booked upon loss of control?
Answer: The difference should be recognized in the income statement upon loss of control.

Any difference between the cost of the retained interest and its fair value on the date the entity loses control of the investee meets the definitions of income or expenses in the Conceptual Framework for Financial Reporting. Accordingly, the IFRIC concluded that, applying IAS 1.88, Downsize recognizes this difference in profit or loss. This is the case regardless of whether Downsize presents subsequent changes in fair value of the retained interest in profit or loss or OCI.

The IFRIC also noted that its conclusion is consistent with the requirements in IAS 28.22(b) and IAS 27.18B, which deal with similar and related issues.



Issue based on IFRIC agenda decision published in June 2018

Question: How should L&M present these arrangements in its Statement of Cash Flows? As a financing arrangement or as part of its cash and cash equivalents?
Answer: Probably as a financing cash flow and NOT part of cash and cash equivalents.

<u>Per June 2018 IFRIC Update</u>:
The Committee observed that:

a. applying paragraph 8 of IAS 7, an entity generally considers bank borrowings to be financing activities. An entity, however, includes a bank borrowing as a component of cash and cash equivalents only in the particular circumstances described in paragraph 8 of IAS 7—ie the banking arrangement is a bank overdraft that (i) is repayable on demand, and (ii) forms an integral part of the entity's cash management.
b. cash management includes managing cash and cash equivalents for the purpose of meeting short-term cash commitments rather than for investment or other purposes (paragraphs 7 and 9 of IAS 7). Assessing whether a banking arrangement is an integral part of an entity's cash management is a matter of facts and circumstances.
c. if the balance of a banking arrangement does not often fluctuate from being negative to positive, then this indicates that the arrangement does not form an integral part of the entity's cash management and, instead, represents a form of financing.

In the fact pattern described in the request, the Committee concluded that the entity does not include the short-term arrangements as components of cash and cash equivalents. This is because these ***short-term arrangements are <u>not</u> repayable on demand***. Additionally, the fact that ***the balance does not often fluctuate from being negative to positive indicates that the short-term arrangements are a form of financing rather than an integral part of the entity's cash management***.

The Committee also noted that paragraphs 45 and 46 of IAS 7 require an entity to (a) disclose the components of cash and cash equivalents and present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in its statement of financial position; and (b) disclose the policy which it adopts in determining the composition of cash and cash equivalents.