Accounting Standards Board
AcSB
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Conseil des normes comptables

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August 29, 2012

Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Annual Improvements to IFRSs 2010 – 2012 Cycle (ED/2012/1)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Annual Improvements to IFRSs 2010 – 2012 Cycle," issued in May 2012.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises, without modification or interpretation. The AcSB consists of members from a variety of backgrounds, including preparers, advisors, academics and financial statement users. Additional information about the AcSB can be found at www.frascanada.ca.

The views expressed in this letter take into account comments from individual members of the AcSB and its staff. However, they do not necessarily represent a common view of the AcSB, its committees or staff. Views of the AcSB are developed only through due process.

In general, we support the amendments to IFRSs proposed in the Exposure Draft. However, we think that a number of revisions are needed to clarify the proposals so as to address the issues raised in the Exposure Draft adequately. Our main concerns are as follows:

- IFRS 3 *Business Combinations* – We agree that contingent consideration that is not classified as equity should be measured at fair value, consistent with the principles of IFRS 3. However, we do not agree with presenting any portion of the change in fair value of contingent consideration classified as a liability in other comprehensive income. Contingent consideration is not "designated" at fair value – it is required to be measured at fair value. We do not see any benefit in bifurcating changes in the fair value of contingent consideration.

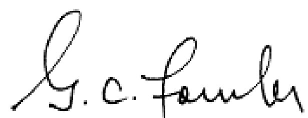
- IFRS 13 *Fair Value Measurement* – IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* should be clarified with respect to the measurement of short-term receivables and payables rather than providing guidance in the Basis for Conclusions on IFRS 13. The Basis for Conclusions is non-authoritative, less likely to be read by preparers, auditors and others and not necessarily available in all jurisdictions.

- *Transition provisions* – The proposed amendment to IFRS 2 *Share-based Payment* should be applied on a prospective basis rather than retrospectively to prevent the use of hindsight to calculate the grant date fair value. The proposed amendment to IFRS 3 should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2015 in order to prevent an entity that does not have a calendar year end applying the amended IFRS 3 before IFRS 9 becomes effective.

Explanations of these key points and others, including some suggested revisions to the Exposure Draft proposals, are provided in the Appendix to this letter as part of the responses to the questions set out in the Exposure Draft.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact Peter Martin, Director, Accounting Standards at +1 416 204-3276 (email peter.martin@cica.ca), or Nicky Lahner, Principal, Accounting Standards at +1 416 204-3348 (email nicky.lahner@cica.ca).

Yours truly,



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APPENDIX

Comments of the Canadian Accounting Standards Board on the IASB's Exposure Draft, "Annual Improvements to IFRSs 2010 – 2012 Cycle" dated May 2012

Question 1:

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

1. Yes. In general we agree with the proposed amendments, but there are a few changes we think should be made to clarify the amendments.

   IFRS 2 *Share-based Payment* – Definition of "vesting conditions"

2. We agree with providing definitions of a "performance condition" and a "service condition" separately from the definition of 'vesting conditions' and including additional clarifications within each definition because this would reduce divergence in the application of IFRS 2. However, we note that the definition of "vesting conditions" includes the statement that "A **performance condition** might include a **market condition**." We think that this sentence should rather be included at the end of the definition of a performance condition, similar to the proposed definition of a "service condition", which includes the statement, "A service condition does not require a performance target to be met."

3. The Basis for Conclusions refers to a "correlation between an employee's responsibility and the performance target" (paragraph BC3 (a) and BC4). We are concerned that this statement may imply that an entity is required to prove correlation between the award and an increase in the performance, either quantum or quality, of the recipient. Therefore, we recommend that the correlation statement should be removed from the Basis for Conclusions.

   IFRS 3 *Business Combinations* – Accounting for contingent consideration

4. We agree with the proposed change to paragraph 40 of IFRS 3. We are aware of contingent consideration that is settled by the transfer of non-financial items such as software licences, PP&E and inventory items. However, we think that the relevant principle is that contingent

consideration other than that meeting the definition of equity should be measured at fair value. Therefore, we agree that it is not necessary to refer to standards other than IAS 32 *Financial Instruments: Presentation* to classify contingent consideration that meets the definition of equity.

5. We agree with the proposed amendment to IFRS 3 that contingent consideration that meets the definition of a financial instrument but is not classified as equity should be measured at fair value, consistent with the principles of IFRS 3. We also agree that subsequent measurement of contingent consideration not classified as equity should be at fair value.

6. We do not agree with the proposed amendment to paragraph 4.2.1 (e) of IFRS 9 that would require "changes in the fair value of the financial liabilities being presented in accordance with paragraphs 5.7.7-5.7.8 as if they had been designated at fair value through profit or loss at initial recognition".

7. Paragraphs 5.7.7-5.7.8 apply when the reporting entity elects to measure a financial liability at fair value in accordance with paragraph 4.2.2. We think the proposed change is inconsistent with the presentation principle in IFRS 9 because contingent consideration is not "designated" at fair value under current standards – it is <u>required</u> to be measured at fair value.

8. We do not think that fair value measurement of contingent consideration is analogous to the use of the fair value option for financial liabilities. We understand that the purpose of presenting changes in fair value due to changes in the issuer's credit risk in other comprehensive income when the fair value option is used is to avoid any deliberate attempt to conceal credit deterioration by electing a treatment that results in reporting counterintuitive gains in profit or loss. This concern is not relevant to contingent consideration. It is unclear to us what the benefit is in complicating the accounting for contingent consideration by requiring the bifurcation of own credit risk.

9. Contingent consideration in a business combination is usually triggered by achieving, or failing to achieve, some sort of performance target. The resulting instruments would meet the definition of a derivative in IAS 39/IFRS 9 if the exception for payments based on a non-

financial variable specific to a party to the contract were removed. We think that derivative accounting is a better analogy than fair value option accounting and that all gains and losses on contingent consideration should be recorded in profit or loss.

10. We think that the IASB or the IFRIC should undertake a project to revisit the definition of a derivative. Although we are sympathetic to concerns about overlap between derivatives and insurance or revenue contracts, we think that the existing overlap between IFRS 3 and IFRS 9 (IAS 39) is an example of the difficulties in determining the accounting treatment of contracts that fail to meet the current definition of a derivative.

IFRS 8 *Operating Segments* – Aggregation of operating segments and reconciliation of the total of the reportable segments' assets to the entity's assets

11. We agree with the proposed amendments.

IFRS 13 *Fair Value Measurement* – Measurement of short-term receivables and payables

12. We think that IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* should be clarified rather than providing guidance in the Basis for Conclusions on IFRS 13. In common with other IFRS adopters, Canada has adopted only the unaccompanied IFRSs and therefore any changes made to the Basis for Conclusions would not be included in national standards. The AcSB thinks that a Basis for Conclusions should be restricted to describing why and how standards are developed and not include any guidance for applying them.

13. An explicit statement should be made in the standards to confirm that short-term receivables and payables with no stated interest rate can be measured at invoice amounts without discounting, when the effect of not discounting is immaterial.

14. We recommend that a paragraph be added to IFRS 9 and IAS 39 to clarify that:

    > "When the fair value approximates the stated amount, i.e., when the effect of not discounting is not material, an entity may measure short-term receivables and payables with no stated interest rate at the invoice amount without discounting."

IAS 1 *Presentation of Financial Statements* – Current/non-current classification of liabilities

15. We recommend that the clarification to IAS 1 should use terminology that is consistent with IFRS 9 and IAS 39. The proposed amendment to IAS 1 is to clarify that the refinance or rollover of an obligation is required to be "with the same leader on the *same or similar* terms" (emphasis added). The Basis for Conclusions refers to paragraph 3.2.2 of IFRS 9 and paragraph 40 of IAS 39 that states that a *substantial modification* of the terms of an existing financial liability shall be accounted for as an extinguishment of the original financial liability (emphasis added) (paragraph BC1). In addition, the Basis for Conclusions states that "the Board thinks that if an entity expects, and has the discretion to refinance, an existing loan on *substantially different terms* then classification of the loan as non-current at the reporting date would not be consistent…." (emphasis added) (paragraph BC2).

16. Therefore, we recommend that paragraph 73 of IAS 1 should be amended to replace the phrase "same or similar terms" with "on terms that are not substantially different".

17. The Basis for Conclusions also states that "In the Board's view, terms are similar if the amendment of the terms would be expected to result in no substantial change to the rights and obligations of the parties to the loan facility" (paragraph BC2). We think that this is a strong statement. We recommend that the statement be included in the standard rather than in the Basis for Conclusions because it summarizes the clarification.

IAS 7 *Statement of Cash Flows* – Interest paid that is capitalized

18. We agree with the proposed amendment.

IAS 12 *Income Taxes* – Recognition of deferred tax assets for unrealized losses

19. We agree with the proposed amendments, but we think that the amendments could be clarified in the following ways.

20. First, the sentence "Tax law offsets all deductions against taxable income from all sources" in the first paragraph of the example after paragraph 29 in IAS 12 is not clear and may also be untrue. We recommend that the sentence be revised to clarify that:

    "An entity is allowed to offset all allowable deductions under the applicable tax law against its taxable income."

21. Second, the example after paragraph 29 is confusing because the facts state that the entity has a deductible temporary difference of 70 and the entity concludes that it will probably file a tax return showing a taxable profit of nil and tax losses of nil in the period in which the temporary difference reverses. As a result, the example takes nil plus 70 to arrive at probable future taxable profit. It would be less confusing if the example showed a taxable profit after deducting the temporary difference of, perhaps, 50. The entity would then compare the deductible temporary difference of 70 with its probable future taxable profit of 120 (50 plus 70).

IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* – Proportionate restatement of accumulated depreciation when using the revaluation method

22. We agree with the proposed amendment but we do not agree with the use of the proposed term "*net* carrying amounts" (emphasis added) in paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38. *Net* carrying amount is not a term used in IAS 16. Carrying amount is defined as "the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses" (paragraph 6 of IAS 16). Paragraph 8 of IAS 38 has a similar definition. We recommend that the word "net" in paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38 be removed to be consistent with the definition.

23. We agree with the examples in paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38 because the examples demonstrate how the gross carrying amount may be calculated.

IAS 24 *Related Party Disclosures*– Key management personnel

24. We agree with the proposed amendment.

IAS 36 *Impairment of Assets*– Harmonization of disclosures for value in use and fair value less costs of disposal

25. We agree with the proposed amendment. However, we note that the statement "An entity is not required to provide the disclosures required by IFRS 13" is not new text and should not be underlined in paragraph 130 (f) because it has not been amended. However, we also think that this statement does not make sense. It is unclear whether the disclosures are required because IFRS 13 says so, despite what IAS 36 requires or whether they are required despite what IFRS 13 says. In addition, we do not know which disclosures are exempt and whether all of them are exempt.

26. Paragraph BC 1 of the Basis for Conclusions includes a reference for disclosures required for fair value less costs of disposals, but there is no reference cited for disclosures required for value in use. We propose that the last sentence of paragraph BC1 be drafted as "This is consistent with the disclosures that are required for the VIU calculation (paragraph 134(d)(iii) and (iv)".

Question 2:

Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

1. Yes. We agree with the proposed transitional provisions and effective date for each of the proposed amendments, except for the transition provisions described below.

IFRS 2 *Share-based Payment* – Definition of "vesting conditions"

2. The amendments to IFRS 2 propose that they be applied on a retrospective basis. We are concerned that changes to the definitions of performance and service conditions may result in changes to the grant date fair value. A retrospective application would require the use of hindsight to calculate the fair value. We recommend that the amendment to IFRS 2 be applied on a prospective basis.

IFRS 3 *Business Combinations* – Accounting for contingent consideration

3. The amendments to IFRS 3 propose that they be applied "prospectively to business combinations for which the *acquisition date* is on or after 1 January 2015" (emphasis added) (paragraph 64G). However, IFRS 9 is effective for annual periods beginning on or after January 1, 2015. This could result in an entity that does not have a calendar year end applying the amended IFRS 3 before IFRS 9 becomes effective. The entity may have a business acquisition on or after January 1, 2015 but before the beginning of their annual period that starts after January 1, 2015.

4. We recommend that the transition provision in paragraph 64G of IFRS 3 mirror the transition provision in paragraph 64. We propose that the transition provision be revised as follows:

   "An entity shall apply that amendment to those paragraphs prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2015."

IFRS 8 *Operating Segments* – Aggregation of operating segments and reconciliation of the total of the reportable segments' assets to the entity's assets

5. The amendments to IFRS 8 propose that an entity must disclose the fact if it applies these disclosure amendments earlier than the effective date. We do not agree with this requirement. Reporting entities frequently provide additional disclosures to those required by IFRSs. They do not indicate that the disclosure is not required by IFRSs. This boilerplate disclosure will not be of value to users and there seems no reason to require it. If the IASB

decides not alter its proposal, than we recommend that it explain the rationale in the Basis for Conclusions.