



IFRS Update

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D&Co IFRS update



Agenda

- 3 new standards under IFRS
 - IFRS 9 Financial Instruments
 - IFRS 15 Revenue from Contracts with Customers
 - IFRS 16 Leases

Agenda

- Some narrow scope amendments to other standards
- Honorable mention of:
 - some specific industry issues (cryptocurrency and cannabis)
- What the Heck series



Overview – IFRS 9

- Effective for years commencing on or after January 1, 2018
- Uses a business model test for assets (classifications based on how they are managed)
- Affects long term loans, equity investments, non-vanilla financial assets and hedging

IFRS 9 – Asset classification

- Now 2.5 classifications for financial assets (previously 4)
 1. Amortized cost (effective interest method) – assets held to collect contractual cash flows only
 2. Amortized costs and for sale – assets held to collect contractual cash flows and for sale
 3. Fair value

IFRS 9 – Asset classification

- Determine the type of asset. Is it:
 - receivable – vanilla or not
 - Equity – must be fair value
- For **Vanilla receivable** - Use the business model test
 - Business model is hold, classify as amortized cost
 - Business model is sell , classify FVOCI
- For **other receivable** (“FVTPL”)

IFRS 9 – Asset classification

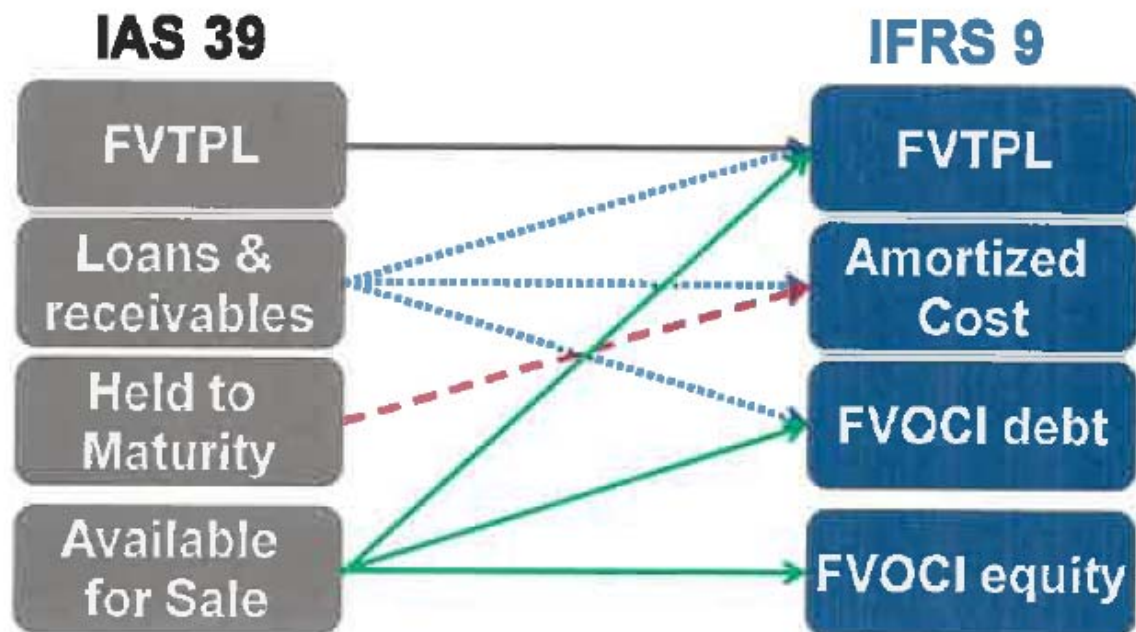
- If the financial asset is **equity** (shares in a public or private company)
 - Elect at initial recognition for each asset purchased to recognize changes in value as **FVTPL or FVOCI**. (note FVOCI never hits P&L)

IFRS 9 – Asset classification

- Show off your analysis to your audit committee, board of directors and your auditors

IFRS 9 – Asset classification

Likely Reclassifications of Financial Assets






IFRS 9 – Measurement considerations

Receivables

- are measured using one impairment test – the Expected Credit Loss (“ECL”) approach
- “12 month ECL’s”, “lifetime ECL”, “lifetime credit impaired ECL”

IFRS 9 – Measurement considerations

IFRS 9: Expected Credit Loss Model

1	2	3
On Balance Sheet:		
Expected Credit Losses for 12 months	<u>Lifetime</u> Expected Credit Losses	<u>Lifetime</u> Expected Credit Losses Credit Impaired
		
On Statement of P&L:		
Investment income using effective interest rate on gross cash flows	Investment income using effective interest rate on gross cash flows	Investment income using effective interest rate on <u>amortized cost after write-down</u>

IFRS 9 – Measurement considerations

- For trade receivables can use a simplified approach
 - Record lifetime ECL's at initial recognition of trade receivable

IFRS 9 – Asset measurement

- Bit of conflict on measuring complex receivables
- Theoretically add the fair value of the components within the instrument
- Guidance indicates fair value day one is based on transaction price
- Practically may have component values higher or lower than transaction price, particularly with valuation models.

IFRS 9 – Financial liabilities

- Not a lot of change from IAS 39
- Still have either of FVTPL and amortized cost
- Hedging - Revised standard is simpler to apply

IFRS 9 – Disclosure

- More!
 - Analysis
 - Information on credit risk
 - Reconciliations

IFRS 9 – Transition

- Should be applied retrospectively, no requirement to restate comparatives but must reconcile opening retained earnings and OCI



IFRS 15 – overview

- *Revenue from contracts with customers*
- Effective for years commencing on or after January 1, 2018
- Creates one comprehensive model to account for revenue from contracts with customers

IFRS 15 – overview

- Replaces six standards
- IAS 18 was 9 pages long, IFRS 15 is over 50 pages

IFRS 15 – a new way of thinking

- Recognize revenue upon a transfer of control of a good or service, previously risk and reward model
- Principles based, but there is a lot of prescriptive guidance (over 100 examples)

IFRS 15 – a new way of thinking

- Document how the requirements in the standard are met
- Biggest impact will be on telecommunication, real estate and licensing companies
- Big increase in disclosure

IFRS 15 – application

- 5 step model to achieve the core principle
 - Identify the contract with the customer
 - Identify the performance obligations
 - Determine the transaction price
 - Allocate the transaction price to the performance obligations
 - Recognize revenue when the performance obligation is satisfied

IFRS 15 – Identify the contract with the customer

- An agreement that creates *enforceable* rights and obligations
- May be written, verbal or based on regular customer business practices
- Can identify payment terms
- Probability of collection

IFRS 15 – Identify the performance obligations

- Promises to transfer goods or services to a customer
- If *distinct*, then account for separately
- If not distinct, then combine

IFRS 15 – Determine the transaction price

- Amount of consideration a company expects to be entitled to
- Could be:
 - fixed amount
 - variable amount ('expected amount' or 'most likely amount')

IFRS 15 – Allocate transaction price to the performance obligations

- Generally done in proportion to their stand-alone prices of the good or service promised in the contract
- Methods for estimating stand-alone prices:
 - adjusted market assessment approach
 - expected cost plus a margin approach
 - residual approach

IFRS 15 – Recognize revenue when the performance obligation is satisfied

- The asset is transferred when or as the customer obtains control of that asset
- Indicators of transfer of control
- Measure progress over time using one method, either of output or input method.

IFRS 15 – Disclosure requirements

- Disaggregation of revenue (many)
- Significant judgements

IFRS 15 – Transition approaches

- Full retrospective adoption;
or
- Modified retrospective adoption



IFRS 16 - Leases

- Effective for years commencing on or after January 1, 2019
- Effect is on the Lessee, little change for Lessor
- Capitalizes all but immaterial and short term leases – practical expedient
- one lease model for Lessees

IFRS 16 – impact – most companies

- If your company leases office/retail/warehouse space, vehicles, equipment or other arrangements, you are affected

IFRS 16 – exemptions

- Leases of non-regenerative assets (mineral property, O&G interests, other)
- Leases of biological assets
- Service concession arrangements
- Licenses of intellectual property granted by lessor
- Rights held by a lessee under certain licensing arrangements

- Practical expedient for short term immaterial leases (which should be disclosed in FS)

IFRS 16 – Contracts

IFRS 16.9

At inception of a contract, an entity shall assess whether the contract is, or contains, a lease...

...if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

IFRS 16 – Identification considerations

- There is an identified asset (lessor cannot substitute for their own benefit)
- Right to obtain substantially all of the economic benefits from using the asset
- Right to direct how to use the asset
- Decisions determined during and before the period of use
- Protective rights

IFRS 16 – Components

- Lease and non-lease
- Account for each separately unless applying practical expedients
 - can account for as a single lease but must disclose the practical expedient has been applied

IFRS 16 – Portfolio approach

- Can use for leases with similar characteristics
- Practical expedient so disclose it

IFRS 16 – Lease Measurement

- 1) Lease term
- 2) Lease payments
- 3) Determine Discount rates
- 4) Calculate PV of future lease payments



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Company

IFRS 16 – Lease Measurement - Term

- Non-cancellable period together with both:
 - Option to extend if reasonably certain to exercise that option
 - Option to terminate if reasonably certain not to exercise that option

IFRS 16 – Lease Measurement - Payments

- Fixed payments and in-substance (unavoidable) payments
- Variable payments with linked index or rate
- Lease incentives (deduct)
- Purchase option (if exercise expected)
- Termination penalty (if exercise expected)
- Residual guarantees

IFRS 16 – Lease Measurement – Discount Rate

- Use either
 - Interest rate implicit in the lease, if readily determinable, otherwise
 - Incremental borrowing rate for lessee

IFRS 16 – Lease measurement - PV

- NPV based on term, payment amounts and discount rate

IFRS 16 – Right Of Use Asset

Includes:

- Lease liability
- Lease payments before commencement date (less any incentives)
- Initial direct costs
- Decommissioning estimates

IFRS 16 – Reassessment of Liability

Re-measure if there is a change in:

- lease term
- assessment of option to purchase
- amounts payable for residual guarantees
- index or rate related to lease payments

Change is reflected in Lease Liability and the related Right Of Use asset, and likely a P&L effect as well.

IFRS 16 – Lease modifications

- Re-measure
- Account as separate lease if:
 - Lease scope is increased by adding right of use asset(s) and
 - Consideration increases by a commensurate stand-alone price for the increased scope
- If not a separate lease
 - Adjust lease liability and related right of use asset, likely P&L effect

IFRS 16 – Presentation

- **Statement of Financial Position**
 - Right of use assets with offsetting lease liabilities
- **Statement of Operations**
 - Interest expense (using effective interest rate method)
 - Accretion
 - Depreciation
- **Statement of Cash Flows**
 - Addbacks on non-cash items
 - Principal repayments in financing activities
- New estimates and judgements will be required
- New disclosure requirements

IFRS 16 – Transition

- Choose full or modified retrospective transition approach
- If modified approach, just look forward.
- Need to show reconciliation (including cleanup of any related prepaids or accruals)

IFRS 16 – Ongoing

Watch for:

- changes in lease terms or estimates
- embedded leases within service contracts
- separate impairment considerations of Right Of Use assets
- Subleases – intermediate lessor
 - Is sublease financing or operating
 - If financing, de-recognition of part of asset but liability has different counterparties

IFRS 16 – Internal Documentation

- You will need to substantiate the assessment of all contracts in the context of the standard
- Create a list of all leases with a summary of terms
- Expectations and estimations

IFRS 16 – accounting overview

- Show off your analysis to your audit committee, board of directors and your auditors



Narrow scope amendments

- **IAS 7 – Statement of Cash Flows**
- **IAS 12 – Income Taxes**
- **IAS 23 – Borrowing Costs**
 - debt outstanding after related asset is ready for use is general borrowing
- **IAS 28 – Long Term Interests in Associates and JV's**
- **IAS 40 – Investment Property**

Narrow scope amendments

- **IFRS 2 - Share-based Payments** (endorsed)
- **IFRS 3 – Business Combinations**
 - Party obtaining control of a joint operation is a business combination achieved in stages with re-measurements of FV at acquisition dates
- **IFRS 9 – Financial Instruments**
 - Debt modifications result in immediate recognition of a gain or loss
- **IFRS 11 – Joint Arrangements**
 - Party obtaining joint control of a business that is a joint operation has no re-measurement of FV
- **IFRS 17 – Insurance Contracts**

Narrow scope amendments

- **IFRIC 22 – Foreign currency transactions and advance consideration**
- **IFRIC 23 – Uncertainty over income tax**
 - If an entity chooses tax treatment that is not probable to be accepted by tax authorities, should recognize the uncertainty in its income tax accounting
 - Detection risk is not considered

Honorable mention

Cryptocurrency Industry

- **Not an investment under IAS 39 or IFRS 9**
- **Is it an intangible asset (IAS 38) or inventory (IAS 2)**
- **If inventory, lower or cost or NRV OR if meeting broker-trader status then FV less costs to sell**
- **Revenue recognition issues under IFRS 15 for miners**

Requires lots of consideration and position papers

Canadian accounting bodies and Regulators are working to provide guidance within the existing IFRS framework

Honorable mention

Cannabis Industry

- **Biological assets under IAS 41 requires FV measurement**
- **Revenue recognition under IAS 18 and IFRS 15**
- **Differing application of FV changes of biological asset within IS**
- **Differing application of components of cost of sales**
 - No specific guidance
 - FV changes in COGs can result in GP being higher than sales
- **October 17, 2018 Canada reduced haze of cannabis through legalization**
- **Cross border considerations – not legal at federal level in USA**
- **IFRS Discussion Group (IDG) considered in June, 2018**

Canadian accounting bodies and Regulators are working to provide guidance within the existing IFRS framework

Recap

IFRS 9 recap

- Affects all companies, at least for disclosure
 - Two categories for financial assets (amortized cost or fair value)
- Classification based on business model
- New Impairment model
- Disclosure

Recap

IFRS 15 recap

- Big effect on software, telecoms, real estate
- New criteria to recognize revenue when customer has control of the goods or services
- Lots of new disclosure

Recap

IFRS 16 recap

- Affects almost all companies
- Only one type of lease (finance) with exceptions (short term leases and low dollar impact)
- Requires consideration of all contracts
- Requires lease summaries and analysis
- NPV calculations, lots of assumptions and disclosures
- Pervasive effect on financial statements

Final take-aways

- Q1 2019 comes quickly after the year end statements are finished
- What are you waiting for
 - What The Heck