Current Developments: IFRS

December 2017

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Quarterly update

Each quarter, we provide a summary of newly effective and forthcoming standards as well as other accounting and financial reporting developments. This edition covers current developments released prior to December 31, 2017.

What happened this quarter?

This quarter, the International Accounting Standards Board (IASB) issued Annual Improvements to IFRS Standards (2015-2017) Cycle which proposes narrow scope amendments to several standards, Prepayment Features with Negative Compensation (Amendments to IFRS 9), and Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28).

Year-to-date summary

During the year, the IASB issued IFRS 17 Insurance Contracts, effective January 1, 2021, IFRIC Interpretation 23 Uncertainty over Income Tax Treatments, effective January 1, 2019, and a Materiality Practice Statement which provides non-mandatory guidance on applying materiality in the financial statements.

Additionally, the IASB issued a number of exposure drafts, including proposed amendments to IAS 16 Property, Plant and Equipment to clarify the accounting for sale proceeds before an asset becomes available for use, proposed clarifications to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and proposed minor amendments to IAS 1 Presentation of Financial Statements and IAS 8 on the definition of ‘material’.

Also, the IASB issued its discussion paper with respect to the Disclosure Initiative: Principles of Disclosure.

As a reminder, the effective date for the IASB’s new Revenue and Financial Instruments is finally here. IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments are effective January 1, 2018. The effective date of the new leases standard, IFRS 16, is also rapidly approaching being effective January 1, 2019.

As companies prepare their 2017 annual financial statements (assuming a calendar year end) it is imperative to remember that there is an expectation from regulators and investors, and a requirement under the accounting framework, that detailed and entity-specific disclosures will be provided with respect to the impact of the new standards, and the adoption and implementation efforts. These disclosures should include both qualitative and quantitative data and should be sufficiently robust to provide users with decision useful information. Even for those entities that anticipate little change to the statement of financial position or statement of profit or loss, the changes related to disclosures may be material. When assessing the impact of the new standards, entities should consider possible changes to recognition, measurement, presentation, and disclosures.
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- Prepayment features with Negative Compensation (Amendments to IFRS 9)
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Current Quarter Financial Reporting Matters

New Guidance – Amendments to IFRSs

Annual Improvements to IFRSs 2015-2017 Cycle

In December 2017, as part of its process to make non-urgent but necessary amendments to IFRS, the IASB issued narrow-scope amendments to IFRS 3 Business Combinations and IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs.

The amendments to IFRS 3 and IFRS 11 clarify how a company accounts for increasing its interest in a joint operation that meets the definition of a business:

- if a party maintains (or obtains) joint control, then the previously held interest is not remeasured; and
- if a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value.

The amendments to IAS 12 clarify that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognized consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.

The amendments to IAS 23 clarify that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets – are included in that general pool.

The amendments are effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. Each of the amendments has its own specific transition requirements.

For more details, refer to KPMG’s web article.

Prepayment features with Negative Compensation (Amendments to IFRS 9)

In October 2017, the IASB issued amendments to IFRS 9 clarifying the accounting for financial assets with prepayment features that may result in negative compensation.

For a debt instrument to be eligible for measurement at amortized cost or FVOCI, IFRS 9 requires its contractual cash flows to meet the SPPI criterion – i.e. the cash flows are ‘solely payments of principal and interest’.

Under IFRS 9, a prepayment option in a financial asset meets this criterion if the prepayment amount substantially represents unpaid amounts of principal and interest, which may include ‘reasonable additional compensation’ for early termination of the contract.

Some prepayment options could result in the party that triggers the early termination receiving compensation from the other party (negative compensation) – e.g. a lender could receive an amount less than the unpaid amounts of principal and interest even though the borrower chooses to prepay. In other cases, an event outside the control of both parties may cause early termination.

Applying IFRS 9 would probably result in these instruments being measured at fair value through profit or loss (FVTPL). The Board believed this to be inappropriate because measuring them at amortized cost, using the effective interest method,
provides useful information about the amount, timing and uncertainty of their future cash flows.

The amendment removes the word ‘additional’ so that negative compensation may be regarded as ‘reasonable compensation’ irrespective of the cause of the early termination. Financial assets with these prepayment features can therefore be measured at amortized cost or at FVOCI if they meet the other relevant requirements of IFRS 9.

The amendment is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. Retrospective application is required, subject to relevant transitional reliefs.

For additional information, refer to KPMG’s web article.

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**Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)**

In October 2017, the IASB issued amendments to IAS 28 *Investments in Associates and Joint Ventures*, clarifying that an entity applies IFRS 9 *Financial Instruments* (including its impairment requirements) to long-term interests in an associate or joint venture to which the equity method is not applied.

The amendment will affect companies that finance these entities with preference shares or with loans for which repayment is not expected in the foreseeable future (referred to as long-term interests or ‘LTI’). This is common in the extractive and real estate sectors.

In the amendments to IAS 28 and the accompanying example the IASB clarified that LTI are in the scope of both IFRS 9 and IAS 28 and explain the annual sequence in which both standards are to be applied. In effect, this is a three step annual process:

- apply IFRS 9 independently, ignoring any prior years’ IAS 28 loss absorption;
- true-up past allocations – if necessary, prior years’ IAS 28 loss allocation is trued-up in the current year because the IFRS 9 carrying value may have changed. This may involve recognizing more prior years’ losses, reversing these losses, or re-allocating them between different LTI instruments; and
- recognize current year equity share – any current year IAS 28 losses are allocated to the extent that the remaining LTI balance allows. Any current year IAS 28 profits reverse any unrecognized prior years' losses and then allocations against LTI.

The amendment applies for annual periods beginning on or after January 1, 2019, with transitional reliefs. Early adoption is permitted.

For additional information, refer to KPMG's web article.
Other matters

U.S. Tax Reform

Canadian companies that do business in the United States should prepare to determine the effect of new U.S. tax changes.

H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and is expected to significantly impact companies’ accounting for and reporting of income taxes, and the related processes and controls. The amendments, some of which are effective January 1, 2018 or have retroactive effect to earlier periods, represent the biggest tax overhaul to the United States Tax Code since 1986.

Some of the significant changes are:

- a reduction in the corporate income tax rate to 21% (from 35%);
- repeal of the corporate alternative minimum tax (AMT) for tax years beginning after 2017 and amendments to the AMT credit carryovers;
- expensing of certain capital investments placed in service after September 27, 2017 and before 2023;
- limitations of the deduction for interest expense, including payments of interest involving certain hybrid transactions and hybrid entities which eliminates the tax benefit of some structures commonly used by Canadian multinationals to finance their US operations;
- elimination of the carryback of net operating losses (NOLs) and limitations on the carryovers of NOLs to 80% of taxable income;
- introduction of the “base erosion anti-abuse tax” (BEAT) that targets certain deductible cross-border payments made by US corporations to related parties and operates as a minimum tax if it applies;
- fundamental changes to the taxation of multinational entities, including a shift from the current system of worldwide taxation (with deferral) to a hybrid territorial system, featuring a participation exemption regime which includes a mandatory tax on a deemed repatriation of previously untaxed earnings of 10%-owned foreign corporations, a minimum tax on “global intangible low-taxed income” (GILTI); and
- a number of other changes to the corporate tax rules.

Most of the provisions of the new law, including the rate reductions, generally are effective January 1, 2018. Several provisions, however, are effective on the date of enactment.

IAS 12 Income Taxes requires current and deferred taxes to be measured using tax rates and tax laws that have been enacted or substantively enacted at the end of the reporting period. We believe the legislation in the United States was simultaneously enacted and substantively enacted on the day the President signed the law.

For additional information, refer to KPMG’s TaxNewsFlashCanada U.S Enacts Tax Changes and our publication Impact of US tax reforms on IFRS financial statements.
Previous Quarters’ Financial Reporting Matters

New Guidance – New IFRSs

IFRS 17 – Insurance Contracts

In May 2017, the IASB issued the new insurance contracts standard – IFRS 17 – which will bring fundamental changes to insurance accounting. The new standard will give users of financial statements a whole new perspective, and the ways in which analysts interpret and compare companies will change. The impact on insurers is significant, but will vary between insurers and jurisdictions.

Benefits of the new standard include increased transparency about the profitability of new and in-force business which will provide more insight into an insurer’s financial health. Other effects may include greater volatility in financial results and equity due to the use of current discount rates and assumptions around future cash flows.

Other changes include:

- separate presentation of underwriting and finance results, providing information surrounding the sources of profit and quality of earnings;
- premium volumes will no longer drive the ‘top line’ as investment components and cash received are no longer considered to be revenue;
- accounting for options and guarantees will be more consistent and transparent.

IFRS 17 applies not only to entities that are generally considered insurance entities, but to all entities that:

- issue insurance or reinsurance contracts;
- hold reinsurance contracts; or
- issue investment contracts with a discretionary participation feature (provided that they also issue insurance contracts).

IFRS 17 introduces:

- a single measurement model based on a current fulfillment value that incorporates available information in a way that is consistent with observable market information; and
- a single revenue recognition principle to reflect services provided.

IFRS 17 becomes effective January 1, 2021, however, the timescale will be a challenge and implementation will require the coordination of several functions, including Finance, Actuarial, and IT as well as the introduction of new or upgraded systems, processes and controls.

In September 2017, the IASB established a Transition Resource Group (TRG) for IFRS 17 that will be responsible for analyzing implementation related questions on IFRS 17.

For more information, refer to KPMGs’ webcast series, Navigating the new world, KPMG Insurance Hot Topics IFRS - Insurance, KPMG’s web article and Insurance Contracts – First Impressions.
New Guidance – Amendments to IFRSs

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

Currently, there is ambiguity over how an entity should account for certain types of share-based payment arrangements. In June 2016, the IASB published amendments to IFRS 2 Share-based Payment.

The new requirements could affect the classification and/or measurement of these arrangements – and potentially the timing and amount of expense recognized for new and outstanding awards.

The amendments cover three accounting areas:

- Measurement of cash-settled share-based payments - the amendments clarify that a cash-settled share-based payment is measured using the same approach as for equity-settled share-based payments – i.e. the modified grant date method.

  The new requirements do not change the cumulative amount of expense that is ultimately recognized, because the total consideration for a cash-settled share-based payment is still equal to the cash paid on settlement.

- Classification of share-based payments settled net of tax withholdings - some share-based payment arrangements permit or require the entity to withhold a portion of the shares that would otherwise be issued to the employee, and to pay the tax authorities on the employee’s behalf. The amendments clarify the conditions under which a share-based payment transaction with employees settled net of tax withholding is accounted for as equity-settled.

- Accounting for a modification of a share-based payment from cash-settled to equity-settled - the amendments clarify that at the modification date the liability for the original cash-settled share-based payment is derecognized, and the equity-settled share-based payment is measured at its fair value as at the modification date, and recognized to the extent that the services have been received up to that date, with the difference recognized immediately in profit or loss.

The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively.

Retrospective, or early, application is permitted if information is available without the use of hindsight.

For additional information, refer to KPMG’s web article.

Annual Improvements to IFRSs 2014-2016 Cycle

In December 2016, as part of its process to make non-urgent but necessary amendments to IFRS, the IASB issued narrow-scope amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards, and IAS 28 Investments in Associates and Joint Ventures which are effective for annual periods beginning on or after January 1, 2018.

The amendments to IAS 28 clarify that:

- a venture capital organization, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss. This election can be made on an investment-by-investment basis; and

- a non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture.
The amendments also remove outdated exemptions for first-time adopters of IFRS, which are effective for annual periods beginning on or after January 1, 2018.

For more details, refer to KPMG’s web article.

Transfer of Investment Property (Amendments to IAS 40)

In December 2016, the IASB issued Transfers of Investment Property (Amendments to IAS 40).

The amendments clarify that:

- an entity shall transfer a property to, or from, investment property when, and only when, there is a change in use of a property supported by evidence that a change in use has occurred; and
- the list of circumstances of when a change in use has occurred is non-exhaustive.

The amendments apply for annual periods beginning on or after January 1, 2018.

The transitional provisions allow an entity to apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments (the date of initial application). At the date of initial application, an entity shall also reassess the classification of property held at that date and, if applicable, reclassify property to reflect conditions that exist at that date. An entity is permitted to apply the amendments retrospectively, but only if it does not involve the use of hindsight.

For more details, refer to KPMG’s web article.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

IFRS 17 is effective for annual periods beginning on or after January 1, 2021, well after the effective date of IFRS 9 Financial Instruments, January 1, 2018. IFRS 9 will cover a majority of an insurer’s investments; therefore, the expected differing effective dates created concerns related to temporary volatility and accounting mismatches in profit or loss. Some companies have also expressed concerns about the need to implement two significant changes in accounting on different dates, which will increase costs and complexity.

In September 2016, the IASB issued amendments to its existing insurance contracts standard, IFRS 4. The amendments introduced two approaches that supplement existing options in the Standard that can be used to address the temporary volatility as a result of the different effective dates of IFRS 9 and the forthcoming insurance contracts standard.

The amendments:

- provide a reporting entity (whose predominant activity is to issue insurance contracts) a temporary exemption from applying IFRS 9 until the earlier of:
  a) the application of IFRS 17; or
  b) January 1, 2021 (to be applied at the reporting entity level) (referred to as the ‘temporary exemption’); and
- give entities issuing insurance contracts the option to remove from profit or loss the incremental volatility caused by changes in the measurement of specified financial assets upon application of IFRS 9 (referred to as the ‘overlay approach’). This option will be in place until IFRS 17 comes into effect.
Additionally, the Board decided to provide relief for investors in associates and joint ventures by permitting a Company to not apply uniform accounting policies when the investee applies IAS 39 and the investor applies IFRS 9, or vice versa, when applying the equity method of accounting.

In response to constituents’ concerns that the proposed disclosure requirements for the temporary exemption from applying IFRS 9 Financial Instruments for insurance companies would result in excessive costs and burdens on preparers, the Board has agreed to revise the disclosure requirements. The decision will limit the need to perform solely payments of principal and interest assessments to those financial assets that are not held for trading or managed on a fair value basis.

In March 2017, the Office of the Superintendent of Financial Institutions (OSFI) issued an advisory articulating its expectation that life insurers whose activities are predominantly connected with insurance to apply the temporary exemption from IFRS 9 in annual periods beginning before January 1, 2021. An exception is available for federally regulated life insurers if its federally regulated parent does not meet the predominance test.

Visit our IFRS – Insurance hot topics page for the latest developments in the insurance contracts project. For more information about the decisions taken by the Board during its deliberation process, refer to KPMG publication Insurance IFRS Newsletter Issue 57.

IFRIC Updates

Foreign Currency Transactions – Advance Consideration (IFRIC Interpretation 22)

In December 2016, the IASB issued IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration in response to diversity in practice in determining the appropriate exchange rate to use when translating assets, expenses or income, when foreign currency consideration is paid or received in advance of the item to which it relates.

The Interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date.

The Interpretation may be applied either:

- retrospectively; or
- prospectively to all assets, expenses and income in the scope of the Interpretation initially recognized on or after:
  - the beginning of the reporting period in which the entity first applies the Interpretation; or
  - the beginning of a prior reporting period presented as comparative information in the financial statements.

The Interpretation is applicable for annual periods beginning on or after January 1, 2018.

For more details refer to KPMG’s web article.
Uncertainty over Income Tax Treatments (IFRIC Interpretation 23)

In June 2017, the IASB issued IFRIC Interpretation 23 Uncertainty over Income Tax Treatments in response to diversity in practice for various issues in circumstances in which there is uncertainty in the application of the tax law. While IAS 12 Income Taxes provides requirements on the recognition and measurement of current and deferred tax liabilities and assets, there is diversity in the accounting for income tax treatments that have yet to be accepted by tax authorities.

The Interpretation requires:

- an entity to determine if it is probable that the tax authorities will accept the uncertain tax treatment;
- if it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value depending on whichever method better predicts the resolution of the uncertainty;
- an entity to reassess the judgements and estimates applied if facts and circumstances change (e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority’s right to challenge a treatment expires); and
- an entity to consider whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution.

The Interpretation is applicable for annual periods beginning on or after January 1, 2019 and may be applied on a fully retrospective basis, if this is possible without the use of hindsight, or on a modified retrospective basis, with an adjustment to equity on initial application. Earlier application is permitted.

For more details refer to KPMG’s web article.

Interest and Penalties related to Income Taxes

IFRS Standards do not specifically address how to account for interest and penalties related to income taxes (interest and penalties). Previously entities may have elected an accounting policy to account for interest and penalties in accordance with IAS 12 Income Taxes or IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

In September 2017, the Committee observed that entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 to interest and penalties. Rather, 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 the particular amount payable or receivable is not considered an income tax, then IAS 37 is applied to that amount.

The IFRIC agenda decision is effective immediately. As a result of this clarification, current accounting treatments will need to be re-examined to determine if a change is required. If required, a change in accounting policy is applied retrospectively in accordance with IAS 8.

For more information refer to the IFRIC Update.
IFRS 9 - Modifications or Exchanges of Financial Liabilities that do not Result in Derecognition

Companies that have modified or exchanged fixed rate financial liabilities face a significant change in the accounting for non-substantial modifications that do not result in derecognition.

Common practice under IAS 39 Financial Instruments: Recognition and Measurement is to recalculate the effective interest rate (EIR) at the modification date to reflect the revised contractual cash flows, without recognizing a gain or loss at that date.

The Board clarified that IFRS 9 requires preparers to:

- recalculate the amortized cost of the modified financial liability by discounting the modified contractual cash flows using the original EIR; and
- recognize any adjustment in profit or loss.

The accounting treatment is therefore consistent with that required for modifications of financial assets that do not result in derecognition.

If the initial application of IFRS 9 results in a change in accounting policy for these modifications or exchanges, then retrospective application is required, subject to particular transitional reliefs.

There is no change to the accounting for costs and fees when a liability has been modified (but not substantially) – these are recognized as an adjustment to the carrying amount of the liability and are amortized over the remaining term of the modified liability.

The IASB has highlighted in the Basis for Conclusions in the IFRS 9 Amendments – Prepayment Features with Negative Compensation that the requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition and no further standard-setting is required.

For additional information, refer to KPMG’s web article.
### Other Matters

Other matters that have been presented in previous quarters are outlined as follows:

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<th>Effective Date/Comment Date</th>
<th>Publication</th>
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<tr>
<td><strong>Exposure Drafts, Discussion Papers and Other Guidance</strong></td>
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<tr>
<td>Exposure draft - Property, Plant and Equipment, Proceeds before Intended Use (Proposed Amendments to IAS 16)</td>
<td>Comments were due October 19, 2017</td>
<td>September 2017 Current Developments&lt;br&gt;Refer to KPMG’s publication <em>Accounting for proceeds before an asset’s intended use.</em></td>
</tr>
<tr>
<td>Exposure draft - Accounting Policies and Accounting Estimates (Proposed Amendments to IAS 8)</td>
<td>Comments are due by January 15, 2018</td>
<td>September 2017 Current Developments&lt;br&gt;Refer to KPMG’s publication <em>Accounting policy or estimate?</em></td>
</tr>
<tr>
<td>Exposure draft - Definition of Material (Proposed Amendments to IAS 1 and IAS 8)</td>
<td>Comments are due by January 15, 2018</td>
<td>September 2017 Current Developments&lt;br&gt;Refer to KPMG’s publication <em>Applying materiality when preparing financial statements.</em></td>
</tr>
<tr>
<td>Practice Statement 2: Making Materiality Judgements</td>
<td>Can be applied to financial statements prepared after September 14, 2017.</td>
<td>September 2017 Current Developments&lt;br&gt;Refer to KPMG’s publication <em>Applying materiality when preparing financial statements.</em></td>
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### Other Financial Reporting Matters

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<tr>
<td>Accounting Implications of Rule Changes by Central Clearing Parties Impacting Derivatives, Hedge Accounting and Taxation</td>
<td>January 3, 2017</td>
<td>March 2017 Current Developments</td>
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<td>Foreign Private Issuers now have XBRL Reporting Requirements</td>
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<td>Changes to Bank of Canada Exchange Rates</td>
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<td>Financial Reporting Implications of Brexit</td>
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Looking Ahead

Update on Major Projects

IFRS 15 - Revenue Standard and IFRS 9 Financial Instruments – Now Effective

In May 2014, the IASB and the FASB (“the Boards”) published their new joint standard on revenue recognition – IFRS 15/ASC Topic 606 Revenue from Contracts with Customers (the new revenue standard).

Additionally, in 2014, the IASB issued its completed standard, IFRS 9 Financial Instruments.

The standard includes guidance on:

- classification and measurement of financial assets and liabilities;
- impairment; and
- general hedging.

As a reminder, entities have the option to defer adoption of IFRS 9’s hedge accounting requirements, and continue to apply IAS 39 hedging accounting requirements in their entirety to all of their hedging relationships, until the standard resulting from the IASB’s dynamic risk management (DRM) project is completed. A discussion paper is expected in 2019.

The new standards on revenue recognition and financial instruments are now effective (effective date of January 1, 2018). Entities should be focusing efforts on drafting their first disclosures.

The impact of the new standards in the 2017 annual disclosures are an opportunity for entities to tell the story of the change: the estimated effects on revenue, profit or loss, equity, the key calculations and assumptions being made, and the expected impact going forward.

Entities should also start thinking about the new disclosure requirements contained in IFRS 9 and IFRS 15, some of which may be required disclosures in Q1 2018 upon adoption of the new standards.

More detail is required under both standards, therefore, entities will need to assess whether their current systems and processes are capable of capturing, tracking and aggregating, and reporting information to meet the new disclosure requirements. This may require significant changes to existing data gathering processes, IT systems and internal controls.

For additional information about the Revenue Standard, refer to IFRS – Revenue and Latest on Revenue Recognition, KPMG’s publication Revenue – Transition Options, IFRS 15 - Illustrative disclosures.

For additional information about the Financial Instruments standard, refer to KPMG’s website Financial Instruments - Introducing IFRS 9 and IFRS – Financial instruments.

Update on Financial Instruments Projects

Financial Instruments with Characteristics of Equity (FICE)

IAS 32 Financial Instruments: Presentation includes requirements for the classification of financial instruments between liabilities and equity. These binary classification requirements result in significant practice issues when applied to many financial instruments with characteristics of equity – other than, for example, typical non-redeemable common shares that pay discretionary dividends.

The Board continues to work on the research project, as part of the 2017-2021 work plan, including determining whether improvements can be made to how these
instruments are classified, and to the presentation and disclosure requirements of such instruments.

A summary of the meeting discussions of the IASB staff and Board follows with respect to FICE and DRM follows:

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<tr>
<td>February 2017</td>
<td>• tentative decision to require an entity to apply the Gamma approach, a proposed classification methodology, to the contractual terms of a financial instrument consistently with IAS 32 and IFRS 9 after assessing the interaction with legal and regulatory requirements.</td>
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<td>• discussion of the proposed application guidance and illustrative examples for clarifying how the Gamma approach would apply to the accounting within equity for different subclasses of equity instruments.</td>
</tr>
<tr>
<td>March 2017</td>
<td>• discussion on the application of the Gamma approach to the classification of derivatives on non-controlling interest with an exercise price denominated in a foreign currency and the interaction of the FICE project with other standards and research projects.</td>
</tr>
<tr>
<td>May 2017</td>
<td>• continued discussions on the DRM project by considering two of the focus areas of the project: DRM activities undertaken to stabilize net interest margin and core deposit modelling.</td>
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<td>June 2017</td>
<td>• discussion on events that result in changes to the DRM portfolio, including (1) how new originations impact management’s target profile for the re-pricing of loan portfolios; (2) how DRM reacts to changes in the DRM portfolio; and (3) information relevant to financial reporting.</td>
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September 2017

• IASB staff discussed with the Board (1) prepayment risk and ways to manage it in the context of DRM and (2) hedge accounting and capacity.
• The Board did not make any decisions, but generally agreed with the observations and summary of the staff.

November 2017

• the staff presented two accounting approaches for an accounting model that better reflects DRM in financial reporting.
• specifically, the Board discussed the objectives of the model and whether it should follow: (1) cash flow hedge mechanics; or (2) fair value hedge mechanics.
• Board tentatively agreed that the staff should focus on further developing a model based on cash flow hedge mechanics and begin involving preparers and users of financial statements in their discussions at an early stage.
• Board agreed that the accounting model for DRM should improve transparency, address the capacity issue and provide a simple and reliable performance metric while reflecting the fluid nature of DRM.

December 2017

• the Board decided to: (1) focus first on developing a core model for the most important issues; and (2) to seek feedback on the feasibility of the core model. The manner in which feedback is obtained will be determined at a later date; and to (3) address the non-core issues as a final step.

For more details, refer to KPMG’s IFRS Newsletters: Financial Instruments.
IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16 Leases. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance finance leases and off-balance sheet operating leases. Instead, IFRS 16 introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting. And while lessor accounting remains substantially similar to current practice – i.e., lessors continue to classify leases as finance and operating leases, there are some minor differences, including the fact that lessors look to IFRS 15, Revenue, to split the lease component of a contract from non-lease components.

All entities that lease major assets for use in their business will see an increase in reported assets and liabilities. In addition, entities will also now recognize a front-loaded pattern of expense for most leases, even when they pay constant annual rentals. This will affect a wide variety of organizations across all industries that lease real estate, equipment, and vehicles. The larger the lease portfolio, the greater the impact on key reporting measures.

The new standard makes the distinction between contracts that meet the definition of a lease rather than a service contract even more critical, as leases will now be recognized on the balance sheet. There may be a number of arrangements that are currently accounted for as leases that fall outside the new definition of a lease introduced in IFRS 16.

The new definition increases the focus on who controls the use of the underlying asset throughout the term of the arrangement. On transition to IFRS 16, companies can choose whether to apply a practical expedient to ‘grandfather’ their previous assessment of which existing contracts are, or contain, leases.

Lessee Accounting

For each major lease, a lessee will recognize a liability for the present value of future lease payments. The lease liability will be measured at amortized cost using the effective interest rate, which creates a front-loaded interest expense. The lessee will also recognize a ‘right-of-use’ asset, which will be measured at the amount of the lease liability plus initial direct costs, prepaid lease payments, and estimated costs to dismantle, less any incentives received. Lessees will generally depreciate the right-of-use asset on a straight-line basis.

Additionally, IFRS 16 introduces a requirement to reassess key judgements, such as lease term, at each reporting date, which is a significant change from current guidance. It is no longer possible to compute a lease amortization schedule on lease commencement and roll that schedule forward at each reporting date. Instead, companies will need to consider whether to re-measure the lease liability and right-of-use asset at each reporting date. Significant judgement will likely be needed in determining whether there is a change in relevant factors, or a change in the lessee’s economic incentive to exercise or not exercise renewal or termination options.

What Discount Rate?

A key estimate in IFRS 16 relates to the discount rate used to measure the present value of the lease payments. While the definitions of the discount rate are consistent with IAS 17 Leases, the application of these definitions in the new standard may be complex, especially for lessees, as a discount rate will have to be determined for most leases previously classified as operating leases. The exceptions are leases for which the lessee applies the recognition exemptions. The determination of the appropriate discount rate will be particularly demanding at transition, especially if IFRS 16 is adopted retrospectively.

The discount rate affects the amount of the lessee’s lease liabilities and a host of key financial ratios. The financial statement impacts of having a higher or lower discount...
rate may be pervasive. For example, the discount rate will impact the allocation of total expense between depreciation and interest throughout the lease term. A higher discount rate will reduce depreciation and increase interest expense in each reporting period. Estimating discount rates and documenting the basis of those estimates will be a major task. To help you prepare to adopt IFRS 16, KPMG has recently published, *Leases Discount Rates – What’s the correct rate?*, which provides an overview of how to determine the appropriate discount rate and how this will affect your financial statements.

**What’s included in the lease liability?**

The lease liability is measured at the present value of the lease payments. But the determination of which lease payments should be included in the lease liability, initially and subsequently will determine the scale of the impact of the new standard for lessees.

One key difference from current practice is that certain lease payments are reassessed over the term of the lease, and the lease liability adjusted accordingly. This introduces new balance sheet volatility.

It also requires new systems and processes to determine the revised lease payments and recalculate the lease liability.

Identifying the relevant payments to include in the liability is key to measuring the lease liability. KPMG has recently published *Lease payments – What’s included in the lease liability?* which provides an overview of how to determine the lease payments.

**Effective Date and Transition**

The new standard is effective for annual reporting periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15 *Revenue from Contracts with Customers*.

The choice of transition option will have a significant impact on the extent of data gathering and the timing of system and process changes. Upon adoption, an entity will be able to choose either of the following transition approaches:

(a) **Retrospective approach**

An entity may choose to retrospectively adjust all prior periods presented.

(b) **Modified retrospective approach**

An entity may choose not to restate comparatives and instead adjust opening retained earnings at the date of initial application.

While there are several transition approaches, there are many individual options and practical expediens that can be elected independently of each other, some on a lease-by-lease basis. Most of the transition options involve a trade-off between the costs of implementation and the comparability of the resulting financial information. For lessees with significant lease portfolios, it may be worthwhile to model the different transition options early since the decisions made on transition will continue to affect the company’s financials until the last lease in place on transition has expired. Before the effective date, companies will need to gather significant additional data about their leases, and make new estimates and calculations, as well as decisions about transition. For some companies, a key challenge will be gathering the required data. For others, more judgemental issues will dominate – e.g., identifying which transactions contain leases.
What have we learned?

Now that companies are starting to make headway on their IFRS 16 conversion projects, we’re making some unexpected discoveries about how the new leasing standard is being implemented in practice.

Some companies have found that the standard enhances some key earnings metrics and others have concluded that some of the practical expedients are not as advantageous as they first thought.

Some of the challenges and insights that have been seen in the implementation stage include:

- creating an inventory of lease contracts and extracting the data from the lease contracts: this process will take time and is process-heavy, so running parallel work streams to keep the project on track will be important, especially if your project plan includes a software implementation; and

- identification of embedded leases: under the existing standard it makes little difference whether a contract is classified as an operating lease or as a service. But it does under the new standard. The analysis of whether a component of a contract meets the definition of a lease is proving more difficult than anticipated.

For more details, refer to KPMG’s web article, KPMG’s SlideShare Presentation, First Impressions: IFRS 16 Leases, Leases: Transition Options, Leases Discount Rates – What’s the correct rate?, IFRS 16 - Lease payments, IFRS 16 – What didn’t the standard tell us? and IFRS 16 Illustrative Disclosures Supplement.
## Amended and new IFRSs effective date

### Newly Effective Standards

The effective standards that need to be considered for financial years ending on or after December 31, 2017 are listed below:

<table>
<thead>
<tr>
<th>Effective for years ending</th>
<th>Standards</th>
<th>KPMG’s guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2017</td>
<td><strong>Disclosures on Changes in Financial Liabilities</strong> (Amendments to IAS 7)</td>
<td>Disclosure on changes in financing liabilities.</td>
</tr>
<tr>
<td></td>
<td><strong>Annual Improvements to IFRSs 2014 – 2016 Cycle – IFRS 12 Disclosure of Interests in Other Entities</strong></td>
<td>Annual improvements to IFRS.</td>
</tr>
</tbody>
</table>
Standards not yet Effective, but Available for Early Adoption

A reminder of standards not yet effective for any reporters, but available for early adoption are listed in this table.

<table>
<thead>
<tr>
<th>Effective for years ending</th>
<th>Standards</th>
<th>KPMG’s guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2018</td>
<td>IFRS 15 <em>Revenue from Contracts with Customers</em> and <em>Clarifications to IFRS 15 Revenues from Contracts with Customers</em></td>
<td>Web article (with links to in-depth analysis)</td>
</tr>
<tr>
<td></td>
<td>IFRS 9 <em>Financial Instruments</em></td>
<td>Web article (with links to in-depth analysis)</td>
</tr>
<tr>
<td></td>
<td>Applying IFRS 9 <em>Financial Instruments</em> with IFRS 4 <em>Insurance Contracts (Amendments to IFRS 4)</em></td>
<td>Web article</td>
</tr>
<tr>
<td></td>
<td><em>Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)</em></td>
<td>Web article</td>
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<tr>
<td></td>
<td><em>Foreign Currency Transactions and Advance Consideration (IFRIC Interpretation 22)</em></td>
<td>Web article</td>
</tr>
<tr>
<td></td>
<td><em>Transfers of Investment Property (Amendments to IAS 40)</em></td>
<td>Web article</td>
</tr>
</tbody>
</table>
|                            | Annual Improvements 2014 - 2016 Cycle  
  - IFRS 1 *First-time Adoption of International Financial Reporting Standards: Deletion of short-term exemptions for first-time adopters*  
  - IAS 28 *Investments in Associates and Joint Ventures: Measuring an associate or joint venture at fair value* | Web article |
<table>
<thead>
<tr>
<th>Effective for years ending</th>
<th>Standards</th>
<th>KPMG’s guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2019</td>
<td>IFRS 16 Leases*</td>
<td>Web article (with links to in-depth analysis)</td>
</tr>
<tr>
<td></td>
<td>Uncertainty over Income Taxes (IFRIC Interpretation 23)</td>
<td>Web article</td>
</tr>
<tr>
<td></td>
<td>Annual Improvements 2015 - 2017 Cycle</td>
<td>Web article</td>
</tr>
<tr>
<td></td>
<td>• IAS 23 Borrowing Costs: Borrowing costs eligible for capitalization</td>
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<tr>
<td></td>
<td>• IFRS 3 Business Combinations and IFRS 11 Joint Arrangements:</td>
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<td></td>
<td>Obtaining control (or joint control) of a business that is a joint operation if the company already holds an interest in that business.</td>
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<td></td>
<td>• IAS 12 Income Taxes: Consequences of payments on instruments classified as equity</td>
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<td></td>
<td>Long-term interests in associates and joint ventures (Amendments to IFRS 9 and IAS 28)</td>
<td>Web article</td>
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<td></td>
<td>Prepayment features with Negative Compensation (Amendments to IFRS 9)</td>
<td>Web article</td>
</tr>
</tbody>
</table>

* Early application of IFRS 16 Leases is permitted only for companies that also apply IFRS 15 Revenue from Contracts with Customers.

### Standards Available for Optional Adoption

The IASB has decided to defer the effective date for these amendments indefinitely. Adoption is still permitted.

<table>
<thead>
<tr>
<th>Standards</th>
<th>KPMG’s guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)</td>
<td>Web article</td>
</tr>
</tbody>
</table>
IASB Work Plan

These tables are intended to act as an outlook of the expected final publication date of current IASB’s projects that may impact your financial statements in the future.

**IASB’s research projects and Agenda consultation as well as Interpretation (IFRIC) projects are not included in these tables.**

<table>
<thead>
<tr>
<th>Standard-setting and related projects</th>
<th>Next Milestone</th>
<th>Within 3 months</th>
<th>Within 6 months</th>
<th>After 6 months</th>
<th>KPMG’s Guidance</th>
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<tr>
<td>Conceptual Framework</td>
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<td>March 2018</td>
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<td>Rate-regulated Activities</td>
<td>Discussion Paper or Exposure Draft</td>
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<td>2019</td>
<td>In the Headlines, Issue 2014/20</td>
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<tr>
<td>Disclosure Initiative – Definition of Material (Amendments to IAS 1 and IAS 8)</td>
<td>Exposure Draft feedback</td>
<td></td>
<td>Comments due January 15, 2018</td>
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<td>Web article</td>
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<td>Management Commentary</td>
<td>Exposure Draft</td>
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<th>Published Discussion Papers (DP’s)</th>
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<th>Within 3 months</th>
<th>Within 6 months</th>
<th>After 6 months</th>
<th>KPMG’s Guidance</th>
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</thead>
<tbody>
<tr>
<td>Financial Instruments with Characteristics of Equity</td>
<td>Discussion Paper</td>
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<td>Q2 2018</td>
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<tr>
<td>Goodwill and Impairment</td>
<td>Discussion Paper or Exposure Draft</td>
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<td>Q2 2018</td>
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<td>Primary Financial Statements</td>
<td>Discussion Paper or Exposure Draft</td>
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<td>Principles of Disclosure</td>
<td>Discussion Paper Feedback</td>
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<tr>
<td>Business Combinations under Common Control</td>
<td>Discussion Paper</td>
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<td>H2 2018</td>
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<tr>
<td>Post-implementation Review – IFRS 13 Fair Value Measurement</td>
<td>Request for Information feedback</td>
<td></td>
<td>January 2018</td>
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<td>Web article</td>
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<tr>
<td>Narrow-scope Amendments and Interpretations of IFRS Standards</td>
<td>Next Milestone</td>
<td>Within 3 months</td>
<td>Within 6 months</td>
<td>After 6 months</td>
<td>KPMG Guidance</td>
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<td><strong>Accounting Policies and Accounting Estimates</strong> (Proposed Amendments to IAS 8)</td>
<td>Exposure Draft feedback</td>
<td>Comments due January 15, 2018</td>
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<td><strong>Classification of Liabilities</strong> (Amendments to IAS 1)</td>
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<td><strong>Definition of a Business</strong> (Amendments to IFRS 3)</td>
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<td><strong>Improvements to IFRS 8 Operating Segments</strong> (Proposed amendments to IFRS 8 and IAS 34)</td>
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<td><strong>Availability of a refund</strong> (Amendments to IFRIC 14)</td>
<td>IFRS Amendment</td>
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<tr>
<td><strong>Plan Amendment, Curtailment or Settlement</strong> (Amendment to IAS 19)</td>
<td>IFRS Amendment</td>
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<td>Web article</td>
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<td><strong>Property, Plant and Equipment: Proceeds before Intended Use</strong></td>
<td>IFRS Amendment</td>
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<td>Web article</td>
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<td><strong>Fees in the ‘10 per cent’ test for derecognition</strong> (Amendments to IFRS 9)</td>
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<td><strong>Subsidiary as First-time Adopter</strong> (IFRS 1)</td>
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</table>

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