Financial Reporting Alert
For publicly accountable entities

Key points from the September 2014 meeting of the IFRS Discussion Group

The following is a summary of the issues discussed at the IFRS Discussion Group’s (IDG) 11 September 2014 meeting.

If you are dealing with the issues described in the following pages, please consult your professional advisor for current advice on the application of IFRS.

Issue 1A: IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

IFRS 3, Business Combinations, specifies that contingent consideration payable in a business combination shall be recognised at the acquisition-date fair value as part of the consideration transferred. However, there is no explicit guidance with respect to contingent consideration in an asset purchase outside the scope of IFRS 3.

IDG members were asked to discuss the issue and consider whether other views exist. The following views were presented in the agenda paper:

1. Contingent consideration payable should be measured at fair value and recorded as part of the cost of the purchase.

2. Contingent consideration payable should be measured and recorded at some other point – for example, when the conditions associated with the contingency are met.

3. IFRS guidance is unclear and therefore there is an accounting policy choice.
Proponents of View 1 noted that contingent consideration in a business combination will often meet the definition of a financial instrument because it is contractually agreed upon and it is no different in an asset purchase. While there may be significant judgment in determining the fair value of contingent consideration, this uncertainty does not negate the fact that a financial instrument exists and it should be recorded as part of the cost of the asset purchased.

However, proponents of View 2 noted that in recent IFRIC discussions relating to variable payments for the separate acquisition of property, plant and equipment and intangible assets, an alternative view was that variable payments dependent on actions of the purchaser (that are within its control) do not meet the definition of a financial liability until those actions are performed. Consistent with paragraph 19 of IAS 37, Provisions, Contingent Liabilities and Contingent Assets, only obligations arising from past events that exist independently of the entity’s future actions are recognized as liabilities. As such, it shall be recognized at some other point and measured at the best estimate in accordance with IAS 37.

IDG members had diverse views. Some members found it difficult to ignore the financial instrument requirements in View 1, but most did not believe that it is automatically the right answer. Some members also believed the diversity in views may be due to diverse fact patterns encountered in practice and therefore the answer may be dependent on facts and circumstances rather than an accounting policy choice.

**Action:** IDG members noted this issue has already been raised to the IASB, which is dealing with similar issues (regarding variable payments) as part of the Leases project. Given that the IASB will likely consider this issue once the Leases project is complete, IDG members recommended interested persons should monitor the IASB discussions relating to this issue and determine whether any actions need to be taken at a future date.

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**Issue 1B: IFRS 3, IFRS 15, IAS 18 and IAS 37: Contingent Consideration in an Asset Sale**

In connection with Issue 1A, IDG members were also asked to discuss the accounting for contingent consideration from the perspective of the seller of the asset. The views presented were similar to those presented as part of Issue 1A:

1. Contingent consideration receivable should be measured at fair value and recorded as part of the proceeds on the sale of the asset.
2. Contingent consideration receivable should be measured and recorded at some other point – for example, when the conditions associated with the contingency are met.
3. IFRS guidance is unclear and therefore there is an accounting policy choice.

A majority of IDG members preferred View 1 from a technical perspective. In addition to the financial instrument requirements under View 1 of Issue 1A, proponents of View 1 pointed to IAS 18, Revenue, which specifies revenue should be recorded at fair value. The issue then becomes an issue of measurement where the initial fair value may be estimated to be nil or a nominal amount due to high uncertainty.

Therefore, from a practical perspective, some IDG members noted that one could arrive at a similar answer under View 2 due to hurdles that must be overcome for recording a receivable on day 1 when there is high uncertainty.

IDG members had diverse views. Again, an additional view raised was that the answer could be facts and circumstances dependent. For example, some asset sales would make no commercial sense from the seller’s perspective unless some contingent consideration was recorded. One member pointed out that it would be important to consider whether timing of recognition of contingent consideration should be consistent with de-recognition of the sold asset under IAS 16, Property, Plant and Equipment. IDG members also agreed that the
answer for Issue 1B does not have to be symmetrical to the answer for Issue 1A.

IDG members also noted that given the significant efforts in developing IFRS 15, Revenue from Contracts with Customers, to reduce diversity, it is unlikely that the answer will be an accounting policy choice in the future. In particular, IFRS 15 provides guidance on variable consideration that may be relevant to this scenario. Under IFRS 15, an entity would estimate the variable consideration and include it in the revenue recognized to the extent that a significant reversal will not occur when the uncertainty is resolved.

**Action:** IDG members suggested that the AcSB follow the IFRS 15 Transition Resource Group activities and determine if there is an opportunity to add the issue to its agenda at an appropriate time.

### Issue 2: IFRS 1: Carve-out Financial Statements

IDG members were asked to discuss whether IFRS 1, First-time Adoption of International Financial Reporting Standards, may be applied to carve-out financial statements of a line of business that is not part of a legal sub-group when the overall group already prepares financial statements in full compliance with IFRS.

Several IDG members pointed out whether IFRS 1 is to be applied is a question of fact. If the line of business meets the definition of a “reporting entity” and these are its first financial statements, then IFRS 1 is to be applied. One IDG member noted that the ongoing IASB work on the definition of a reporting entity (now part of the Conceptual Framework project) proposes that a portion of an entity may qualify as a reporting entity: (i) if the economic activities of that portion can be distinguished objectively from the rest of the entity and (ii) financial information about the portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity. Based on this proposed definition, the line of business in question could be a reporting entity and if these are its first financial statements, then they would be required to apply IFRS 1.

However, some members expressed concerns about applying IFRS 1 to an entity that is not transitioning from previous GAAP in that it may also provide opportunities to manipulate financial results of the entity in advance of a transaction or other activity for which the carve-out financial statements are being prepared. In addition, applying IFRS 1 may not make sense if the line of business was already being reported in the IFRS group financial statements as a segment.

Recognizing there may be various purposes for which carve-out financial statements are being prepared, IDG representatives from provincial securities commissions reminded the group that if carve-out financial statements are included in regulatory filings for transactions such as an IPO, then they must contain a statement of full compliance with IFRS pursuant to regulatory requirements.

IDG members also acknowledged there could be instances where IFRS 1 would be useful. As such, the answer may depend on facts and circumstances and will require consideration of the purpose of the carve-out financial statements, the intended users and any applicable regulatory requirements. IFRS 1 may help to achieve full compliance with IFRS where such financial statements are required and the line of business contains historical transactions that were not measured in accordance with IFRS.

**Action:** IDG members discussed this issue to raise awareness. No further action was recommended.

### Issue 3: IAS 19 and IAS 21: Foreign Exchange Gains and Losses on Defined Benefit Pension Plan Obligations

An entity may have a defined benefit plan for which the benefits payable are denominated in a currency other than its functional currency. IAS 19, Employee Benefits, requires periodic remeasurements of the defined benefit obligation,
but it does not contain explicit guidance on the treatment of foreign exchange gains and losses.

IDG members were asked to discuss whether foreign exchange gains and losses resulting from translation of the defined benefit obligation into the sponsor’s functional currency should be recorded in profit and loss or in other comprehensive income in the context of both unfunded and funded plans.

The agenda paper presented the following views:

1. The foreign exchange gains and losses should be recorded in profit and loss.

2. The foreign exchange gains and losses should be recorded in other comprehensive income.

3. A policy choice is available.

4. For funded plans only: The foreign exchange gains and losses on the underlying components of the net defined benefit liability or asset should be recorded in profit and loss or in other comprehensive income according to the nature of the specific components.

**Unfunded plans**

A majority of IDG members supported View 1. These members believed the issue is technically an issue of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, rather than an IAS 19 issue. In this regard, they noted that paragraph 28 of IAS 21 requires foreign exchange differences arising on translating monetary items to be recognized in profit or loss, and paragraph 16 of IAS 21 provides “pensions and other employee benefits to be paid in cash” as an example of a monetary item.

Proponents of View 2 believed that since foreign exchange is a variable that factors into the ultimate cost of providing post-employment benefits, its effects should be recorded in a manner consistent to actuarial gains and losses in other comprehensive income. They questioned how the distinction under View 1 would be helpful to the users of financial statements.

IDG members acknowledged that View 1 would lack this symmetry, but ultimately concluded that View 1 would be the correct application of the standards.

**Funded plans**

In a funded plan, some assets held by the plan may be non-monetary in nature. Therefore, a further complexity arises as to how and where the exchange gains and losses on those non-monetary assets (which form part of the net defined benefit liability or asset) would be calculated and recorded.

Consistent with the reasoning for unfunded plans, a majority of IDG members supported View 1. However, they noted that a two-step approach would be required for a funded plan. First, the plan assets would be translated into the currency in which benefit payments are made and the exchange gains and losses arising from this translation represent a revaluation measurement that would be recorded in other comprehensive income in accordance with IAS 19. Then, the net defined benefit liability or asset would be translated into the entity’s functional currency with exchange gains and losses recorded in profit or loss in accordance with IAS 21.

Some IDG members also found View 4 to be acceptable. However, under this view, the interaction between IAS 19 and paragraphs 23(c) and 30 of IAS 21 results in exchange gains and losses being split between profit or loss and other comprehensive income depending on where the revaluation gains and losses on the non-monetary assets are recorded. The cost-benefit of this view was questioned given the significant additional complexity involved in its application.

One IDG member pointed out that the interplay with the asset ceiling test may also need to be factored into the overall accounting.

**Action:** IDG members discussed this issue to raise awareness. No further action was recommended.
**Issue 4: IAS 19: Refundable Tax Accounts in Retirement Compensation Arrangements**

Under a retirement compensation arrangement, funds contributed by an employer to a trust are invested with the proceeds ultimately distributed to the employee upon retirement. This arrangement is considered a retirement arrangement under IAS 19, *Employee Benefits*.

For every dollar contributed, a dollar must be remitted to the Canada Revenue Agency (CRA). Funds remitted to the CRA are held in a non-interest-bearing Refundable Tax Account (RTA). For every $2 in benefit payments made from the trust, $1 is refunded to the trust from the RTA. The employer is entitled to any remaining funds in the RTA upon wind-up of the trust.

IDG members were asked to discuss how amounts held in the RTA should be accounted for. The following views were presented in the agenda paper:

1. The RTA is a plan asset and should be measured at face value. Interest income is recognized at the discount rate and the remeasurement loss is recognized in other comprehensive income.

2. The RTA is a plan asset and should be measured at face value. As the asset does not bear interest, no interest income should be recognized.

3. The RTA is a plan asset and should be measured at its discounted value and the difference between the face value of the assets and the discounted value will be recorded as an expense. Interest income is recognized at the discount rate.

4. The RTA is a plan asset and should be measured at its discount value. An entry will be recorded in either net income or other comprehensive income. Interest income is recognized at the discount rate.

A majority of IDG members support a discounting approach (i.e. View 3 or 4) to measure the RTA at fair value to reflect the effect of time value between contribution date and expected payout date and its differing nature from cash due to its usage limitations and non-transferability. The fair value would be adjusted for the passage of time. This approach is consistent with measurement of the corresponding defined benefit obligation as well as the measurement of reimbursement rights, qualifying insurance policies, and interest-free loans receivable.

In contrast, proponents of Views 1 and 2 believed that face value represents the amount that will be paid to the trust and hence paid to employees at any time benefits are paid. This amount is equal to the cash held in the RTA.

There were varying views on whether the initial entry for the difference between the face value and the discounted amount should be recorded as an expense (to recognize the cost of the arrangement in the period granted and to achieve symmetry with recognition of interest in future periods) or other comprehensive income (a policy choice, as IAS 19 does not specify where this entry should be recorded).

**Action:** IDG members discussed this issue to raise awareness.

**Issue 5: IAS 32, IAS 33 and IFRIC 17: Dividend Reinvestment Plans**

Many companies in Canada have Dividend Reinvestment Plans (DRIPs) with common features such as:

- Calculating the number of shares to be issued based on dividing the cash dividend declared by 95% of a volume weighted average share price (i.e., effectively a 5% premium over the cash dividend).

- Electing to receive cash versus shares prior to a dividend record date that is prior to the balance sheet date (i.e., the number of shareholders electing to receive shares is often known at balance sheet date).
IDG members were asked to discuss following issues presented in the agenda paper:

1. Should a liability be accrued for the dividend payable as a whole or only for the amount expected to be settled in cash?

2. Should the liability include a 5% premium for amounts to be settled in shares, and should amounts ultimately credited to equity be based on the fair value of the shares on the settlement date?

3. Assuming the shares are recorded at their fair value on issuance, how should any difference between the liability accrued at the balance sheet date and the ultimate settlement amount be recorded?

4. Are views affected when the units are classified as equity because of the puttable instruments amendment in IAS 32 (for example, for certain trusts/real estate investment trusts)?

5. Certain plans are structured as “share dividend plans” rather than dividend reinvestment plans. The typical share dividend plan enables shareholders to receive their dividends directly in the form of common shares, which are issued at a 5% discount from the prevailing market price (as opposed to reinvesting cash dividends). Such plans have certain advantages, including to US shareholders. Is the accounting for such plans subject to different considerations than for dividend reinvestment plans?

IDG members did not express any views for Issue 1. The agenda paper noted that recording at least the cash equivalent obligation seems consistent with practice.

A majority of IDG members believed the answer to Issue 2 is “Yes,” because the entity has a financial liability under IAS 32, Financial Instruments: Presentation, to deliver a variable number of shares to those who elected to participate in the DRIP. The fair value of this liability should be based on the quoted market price of the shares without any discount for liquidity or transaction costs in accordance with IFRS 13, Fair Value Measurement. These members did not support the alternative view where the DRIP is analogized to a right offering described under IAS 33, Earnings per Share.

Continuing with the financial instruments approach, a majority of IDG members believed the answer to Issue 3 is “Yes,” because there is sufficient guidance in IAS 39 that subsequent remeasurements of a financial liability should be recorded in profit or loss. There was no support for the alternative view where IFRIC 17, Distributions of Non-cash Assets to Owners, is applied by analogy to allow for remeasurements of non-cash distribution liabilities through equity.

IDG members did not express any views for Issues 4 and 5.

With respect to Issue 4, the agenda paper noted that while the units are presented as equity due to paragraph 16A and 16B of IAS 32, they are not considered equity for other purposes pursuant to the definition of financial liability and therefore supports the financial instruments approach.

With respect to Issue 5, the agenda paper noted that the substance of these different plans appears to be the same as a DRIP and therefore consistent accounting should apply. IDG members also noted that materiality may be a factor and, if the plans are significant, entities should consider the financial instruments standards as a starting point.

**Action:** IDG members discussed this issue to raise awareness. No further action was recommended.

**Issue 6: Disclosures of Contractual Commitments**

There is no clear or consistent disclosure principle for unrecognized contractual commitments in IFRS. While some standards (e.g., IFRS 12, Disclosure of Interests in Other Entities, IAS 17, Leases, and IAS 24, Related

Key points from the September 2014 meeting of the IFRS Discussion Group
Party Disclosures) describe the notion of commitment in relation to their disclosure objectives, the term “commitment” is not specifically defined in IFRS. Some areas of IFRS focus on an entity’s ability, while others take into account both an entity’s ability and intent.

IDG members were asked to discuss to what extent is the ability to avoid future expenditures relevant for IFRS disclosure purposes. The agenda paper presented the following views:

1. Unrecognized contractual commitments are disclosed regardless of management’s ability or intent to avoid the commitment, unless a specific standard specifies otherwise.

2. Unrecognized contractual commitments are disclosed having regard to management’s ability or intent to avoid the commitment, in addition to other factors specific to an entity.

IDG members discussed types of commitments and their disclosure implications under various scenarios. IDG members noted that it was generally understood that irrevocable commitments requiring an outflow of economic resources are required to be disclosed in accordance with IAS 37.

In addition, IDG members noted that judgment is required to consider whether additional commitment disclosures are required to satisfy the requirements of IAS 1 in order to provide information that is relevant to understanding the financial statements. Such considerations would include the significance of the commitment to key operations or maintenance of key assets and the practicability with respect to cancelling the commitment. An example was discussed in the context of resource exploration entities where disclosure of expenditures needed, but not irrevocably committed, in order to maintain property rights in good standing would be relevant to understanding the assets recognized.

**Action:** IDG members discussed this issue to raise awareness. No further action was recommended.

### Issue 7: IFRS 9 and IAS 39: Flow-through Shares with Attached Share Purchase Warrants

A flow-through share gives an investor rights to a common share of the issuer and a future tax deduction equal to the cost of the initial investment. The tax deduction may be taken once the issuer renounces the qualifying expenditures. Flow-through shares are commonly issued by mining or oil exploration companies, and entities in certain emerging technologies.

IFRS does not explicitly address the accounting for flow-through shares. The accounting for flow-through shares was previously discussed by the IDG and other industry groups.

At this meeting, IDG members were asked to specifically discuss how an issuer should allocate the proceeds received from the issuance of a unit composed of a flow-through share and a warrant classified as equity.

The agenda paper presented the following views:

1. The flow-through liability should be measured at fair value, with the residual proceeds allocated to equity.

2. Both the ordinary share and warrant should be measured at fair value with the remaining proceeds allocated to the flow-through liability.

3. Accounting policy choice.

Proponents of View 1 noted that the transaction is in substance a sale of tax deductions (i.e., the flow-through share liability) and the issuance of common shares and warrants. While a flow-through share liability is not a financial liability, IAS 18, Revenue, and IAS 32, Financial Instruments: Presentation, may be helpful in determining the accounting. With respect to the sale, the obligation to fulfill this liability is similar to unearned revenue, and paragraph 9 of IAS 18 requires revenue to be measured at fair value of the consideration received or receivable. In making the allocation, paragraph 32 of IAS 32 suggests that the equity component is the
residual after deducting the fair value of the liability from the fair value of the flow-through shares with the attached warrants as a whole. Both IAS 18 and IAS 32 support measuring the flow-through share liability at fair value.

Proponents of View 2 noted that IAS 32 is not relevant for measuring the flow-through liability, as it is not a financial liability. Instead, the issuer should focus on measuring the financial instruments (i.e., the flow-through share and the warrant) at fair value and allocate the residual to the flow-through liability.

Conceptually, IDG members expressed support for View 1. However, it was acknowledged that practically, due to challenges in directly measuring the liability, the approach taken may be more similar to View 2. IDG members emphasized that the amounts allocated to each component must be reasonable and significant judgements should be disclosed.

For example, if the liability was allocated zero value, the trading volume of the shares, the financial situation of the issuer and other factors should be considered in evaluating whether zero is a reasonable fair value. In other instances, where valuation techniques are used (e.g., for warrants), judgment may be required to determine whether the outcome reasonably represents fair value.

**Action:** IDG members noted that this issue is unique to Canada and discussed this issue to raise awareness. No further action was recommended.

**Issue 8: Escrow Share Arrangements**

The Capital Pool Company (CPC) Program of the TSX Venture Exchange (TSX-V) allows a shell company to be formed with seed capital from founding investors with the intent to raise funds through an IPO and then complete a qualifying transaction (e.g., acquisition of a business) within 24 months to trade as a regular TSX-V listed company. Certain shares issued by the CPC may be held in escrow pursuant to TSX-V rules and released in tranches over three years once a qualifying transaction occurs. The CPC may be delisted if a qualifying transaction does not occur within the specified timeframe.

IDG members were asked to discuss whether these escrow shares should be considered contingently issuable or contingently returnable shares under IAS 33, *Earnings per Share*, such that they should be excluded from the calculation of basic earnings per share, or if they should be considered ordinary shares such that they are included in basic earnings per share, prior to the qualifying transaction.

A majority of IDG members supported the view that the escrowed shares should be excluded from the calculation of basic earnings per share, because the shares meet the definition of contingently issuable shares in accordance with paragraph 5 of IAS 33, or contingently returnable shares in accordance with paragraph 24 of IAS 33. For inclusion in the calculation of basic earnings per share, the necessary condition to be satisfied, or when the escrow shares are no longer subject to recall, is the completion of the qualifying transaction. IDG members noted that the completion of a qualifying transaction is not perfunctory and have seen escrow share cancellations.

**Action:** IDG members recommended for the AcSB to determine whether there is diversity in practice and, if so, what actions could be taken to raise awareness.

**Issue 9: IFRS 11: Application Issues and Process of IFRS Interpretations Committee**

The IFRS Interpretations Committee (IFRS IC or IFRIC) held various meetings from November 2013 to July 2014 to discuss implementation issues relating to IFRS 11, *Joint Arrangements*. Three key implementation issues were discussed:

- Classification of the joint arrangement (with regards to the assessment of “other facts and circumstances”)

*Key points from the September 2014 meeting of the IFRS Discussion Group*
Accounting by the joint operators

Accounting within the separate financial statements of the joint arrangement

Agenda Paper 2 of the September 2014 IFRIC meeting provided a brief overview of the topics discussed, as well as a summary of the discussions. While IFRIC agenda papers, updates and other such outputs from these meetings are not authoritative, they may contain useful insights and views for entities that are dealing with the issues in practice.

IDG members discussed the IFRS 11 implementation issues to raise awareness and the next steps that are being taken by the IFRIC. The IFRIC member attending this IDG meeting cautioned that one would need to be careful when reading the IFRIC staff papers, as they may not be entirely consistent with conclusions reached during the actual IFRIC discussion. In addition, it was noted that the IFRIC concluded it will not continue to discuss these issues until the IASB’s post-implementation review of IFRS 11 is complete.

**Action:** IDG members discussed this issue to raise awareness. The IDG members also suggested that how the IFRIC’s non-authoritative outputs should be interpreted by preparers of financial statements be a future IDG agenda topic. (Ed: Readers should also consider the minutes of the November IFRIC meetings on this topic.)

### About the IDG

The Canadian Accounting Standards Board (AcSB) formed the IDG to help Canadian Organizations apply IFRS. The IDG discusses IFRS issues raised by constituents and recommends to the AcSB which issues should be brought to the attention of the International Accounting Standards Board (IASB) or the IFRS Interpretations Committee (IFRS IC or IFRIC) for further guidance. The IDG also discusses issues raised by constituents with the sole intent of raising awareness of emerging issues in the Canadian accounting landscape.

Members of the public are encouraged to submit issues in writing to the IDG six weeks in advance of each meeting. The meetings are open to the public and are recorded. Official summaries of the public meetings and the recordings of discussions are posted on the AcSB’s website at frascanada.ca and can be found through the use of the recently updated IDG issues searchable database.

IDG discussions are non-authoritative interpretations of IFRS and do not comprise consensus positions of the IDG. Participants’ comments represent their personal views. The matters discussed may be subject to further deliberation by the IFRIC IC, the IASB or other parties. Therefore, the views described in this document may not remain current or relevant.

### IDG members

The IDG was established in 2009 by the AcSB and consists of auditors, preparers and regulators.

#### Current members

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In addition to members, the AcSB's Chair and Director, Accounting Standards, attend the Group's meetings. Several other individuals also participate in the meetings, including:

**Representatives of the Canadian Securities Administrators**

- Carla-Marie Hait, British Columbia Securities Commission
- Lara Gaede, Alberta Securities Commission
- Cameron McInnis, Ontario Securities Commission

**Canadians serving on IASB committees**

- Reinhard Dotzlaw, Member, IFRS Interpretations Committee

### Learn more

For more information on these and other financial reporting developments, please contact your EY advisor or one of the following professionals:

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