THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

INVESTMENT FUNDS IFRS TOOLKIT

(NOVEMBER 2017 Edition)

Introduction

Most investment funds in Canada were required to adopt IFRS for fiscal years commencing on or after January 1, 2014. To assist member companies, IFIC's Accounting Advisory Working Group is issuing a series of discussion papers on pertinent IFRS issues ("Toolkit") applicable for open-ended investment funds. This Toolkit and the information contained herein are provided for general information purposes only. Presentation of the information does not constitute a legal or any other form of relationship among IFIC and the users of the information. The views expressed in this Toolkit are solely those of IFIC and the individuals listed below who assisted in its development. Since the Toolkit presents information in summary form in certain instances, it is not intended as a substitute for detailed research and professional judgment and advice. Before making any decision or taking any action that might affect your organization or business, you should seek the services of a qualified professional advisor.

The information contained in the Toolkit is provided on an "as is" basis. While IFIC and the individuals listed below have used their best efforts to furnish up-to-date and accurate information, they do not warrant that the information contained herein is accurate, complete, current or error-free. Your use of the Toolkit is at your own risk and you assume full responsibility for risk of loss from its use, including any indirect, incidental, consequential or punitive damages which you might suffer as a result of your reliance upon information contained herein.

These commentaries highlight the key considerations, offer application guidance and provide reference tools. They do not constitute official accounting standards, nor are they definitive in their recommendations, as the facts and circumstances for each entity may vary. However, we expect that these papers should be useful to assist members in navigating the issues and arriving at their own conclusions. The Toolkit does not address specific issues where consolidated financial statements are prepared by an investment fund nor does it address any specific issues for closed-end investment funds.

The four discussion papers currently being issued address the following:

1. Financial Instruments
   Including Appendix A: Proposed Disclosure of Interest Income for Distribution
   Appendix B: IFRS Classification & Measurement of Financial Instruments and Appendix C: Additional Discussion on Business Models
2. Transition to IFRS 9 ***NEW in September 2017***
3. Puttables (Equity Versus Liability Treatment for Issued Capital)
4. Consolidation
5. Presentation & Disclosure

This paper was first published in October 2013 and has been updated for new developments and issue resolutions since that date. IFIC intends to continue to address IFRS issues as the industry moves towards adoption, and may modify the above papers or may release additional discussion papers if warranted.

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Users can also access the CPA website http://www.cpacanada.ca which has additional material to assist financial statement preparers. Should you have any questions or comments regarding any of the content in the discussion papers, please contact John Parker (jparker@ific.ca).

Table of Contents

GUIDANCE ON IFRS RECOGNITION & MEASUREMENT OF FINANCIAL INSTRUMENTS FOR INVESTMENT FUNDS

Relevant IFRS: 9, 13, 18 and IAS 39

Overview

Historically, Canadian investment funds have applied Accounting Guideline 18, Investment Companies (AcG-18), which requires that investment funds meeting the definition of an "investment company" measure their investments at fair value with changes in fair value recorded through profit or loss in the period in which they arise. IFRS does not contain guidance similar to AcG-18.

Under IFRS, IAS 39, Financial Instruments: Recognition and Measurement establishes principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Investment entities will have various considerations in measuring their financial instruments, which include using methods other than fair value in certain instances. It is also important to note that, while the IFRS definition of a financial instrument is consistent with Canadian GAAP, certain investments are not financial instruments, but were accounted for at fair value under AcG 18 based on the entity level assessment that required all investments (not just financial instruments) to be measured at fair value. The following summarizes areas for consideration for financial instruments often held by investment entities. This summary excludes the implications of holding interests in subsidiaries, associates or affiliates, and joint arrangements which are covered under IFRS 10, Consolidated Financial Statements (IFRS 10), IFRS 11, Joint Arrangements (IFRS 11), and IAS 28, Investments in Associates and Joint Ventures (IAS 28).

IFRS	Considerations	Application
IAS 39	Investment entities will need to determine the accounting model that applies to all financial assets and liabilities to determine if fair value measurement continues to be appropriate. IAS 39 will apply on transition, unless IFRS 9 is early adopted (see below re: IFRS 9). Under IFRS, IAS 39 prescribes the following categories of financial instruments: • Fair value through profit or loss (including held for trading and instruments designated as fair value through profit or loss) (FVTPL); • Available for sale (AFS); • Held to maturity; • Loans and receivables; • Financial liabilities at FVTPL; and • Other financial liabilities. September 2017 Update – a new IFRS 9 section has been added below.	• On initial recognition, all financial instruments are measured at fair value plus, in the case of financial asset or liability not classified as FVTPL, directly attributable transaction costs. • Subsequent to initial recognition, measurement depends on the classification in accordance with IAS 39. Investment funds will need to review and determine the appropriate classification for all financial instruments held based on the substance of the contractual terms, intention of the holding and the definitions of the categories in IAS 39.9. • Investment funds will need to assess whether investments held meet the conditions to be classified as "held for trading" and therefore require measurement at fair value through profit or loss. A financial asset or financial liability is classified as held for trading if: (i) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; (ii) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or (iii) it is a derivative. Illustrative examples in IAS 39.IG B.11 and B.12 provide further guidance.

IFRS	Considerations	Application
		• Alternatively, if an instrument or a portfolio of instruments does not qualify as held for trading, FVTPL option may be elected as a policy choice on an investment by investment (or a portfolio by portfolio) basis provided certain strict criteria in IAS 39.9 are met. Application Guidance to IAS 39 describes these criteria in paragraphs AG4B-AG4K. The fund will need to demonstrate that such an election results in a more relevant information because either: o an accounting mismatch is eliminated (e.g. if units are accounted for as liability and measured at FVTPL) or, o the performance of assets is evaluated on FV basis based on risk management and/or investment strategy, which may require significant judgment and interpretation. The fair value option may also be elected if a contract contains one or more embedded derivatives that would otherwise be accounted for separately. A fund may designate an entire hybrid contract as an asset or liability at fair value through profit and loss. • If FVTPL is not available, an investment fund would classify the remaining financial instruments depending on the nature of the investment (such as amortized cost for certain debt instruments or as an AFS investment at fair value through Other Comprehensive Income (OCI)). Classification determines how gains and losses are recognized in income. For instruments carried at amortized cost, gains and losses are recognized in profit and loss using the effective interest method. All gains and losses arising from the changes in fair value of the AFS investments are recognized in OCI, except as follows: o interest calculated using the effective interest method is recognized in income (see Effective Interest Method below). o dividend income on equity instruments is recorded in net income apart from other changes in fair value. o foreign exchanges gains and losses on debt instruments are recognized in income. o impairment losses (and reversals of the impairment losses for debt securities) are recognized in income.

IFRS	Considerations	Application
		• All designations are required to have been made at the date of transition (i.e. January 1, 2013 for calendar year funds). • Any changes in classification and measurement basis from the Canadian GAAP Part V should be applied retrospectively and disclosed in the IFRS 1 reconciliation in the year of transition. • Consider the presentation and disclosure requirements of multiple fair value categories (i.e. FVTPL and HFT); and ability to make the presentation/disclosure meaningful (see Presentation/ Disclosure discussion).
Effective Interest Method	IAS 18, Revenue Paragraph 30(a)	• NI 81-106 Section 3.2(2) requires disclosure of interest revenue. Interest revenue as defined in IAS 18 Revenue is determined using the effective interest method (IAS 18.30). • It is noted that IFRS does not require separate disclosure, either as a line item in the statement(s) of profit or loss and other comprehensive income or in the notes to the statements, of interest revenue on financial assets measured at fair value through profit and loss. Nonetheless NI 81-106 requires the reporting of interest income as it is considered that interest revenue is meaningful to users. The commissions note that IAS 1 indicates an entity shall present additional line items in the statement(s) of profit or loss and other comprehensive income when such information is relevant to an understanding of the entity's financial performance. • In order to meet this regulatory requirement in a set of IFRS financial statements, consideration should be given to the ability to provide interest income calculated on an EIR basis. To the extent that there is no practical ability, an alternative presentation would need to be considered. • Accordingly, for the latter instance, an alternative presentation format has been developed to meet the requirements of NI 81-106 and IAS 1. The presentation involves the use of the term 'interest for distribution purposes'. Reference is made to the attached illustrative example in Appendix A.

IFRS 9	Certain parts of IFRS 9 are available for early adoption and the mandatory effective date is tentatively set for January 1, 2018 as modifications to the standard continue to be deliberated. See Appendices B and C for more details. September 2017 Update – guidance for IFRS 9 transition from IAS 39 has been added below.	• The guidance for classification and measurement of financial instruments in the version of IFRS 9 available for early adoption (i.e. the currently issued version) differs significantly from IAS 39. Consequently, if an investment fund decides to opt for early adoption of IFRS 9, careful consideration will need to be given to how it applies to the fund's specific portfolio of investments (see Appendix B for more details)
Fair Value	IFRS 13, Fair Value Measurement (IFRS 13), became effective January 1, 2013 and defines fair value as exit price (concept similar to U.S. GAAP). The points discussed herein are those where the changes from prior Canadian GAAP are likely to be most impactful to Canadian retail investment funds. It is not a comprehensive analysis of fair valuation as a whole. For investments traded in exchange markets, investment funds will be able to elect to use bid or close prices (must be the most representative price within the bid-ask spread (IFRS 13.70)). Depending on the investment fund's accounting policy for measuring fair value, this could result in the continued need for, or elimination of, reconciliations between net assets and net asset value. Under IFRS 13, fair value measurement relates to a particular asset or liability and therefore should incorporate the asset or liability's specific characteristics if market participants consider these characteristics when pricing the asset or liability. These characteristics could include condition, location and restrictions, if any, on sale or use as of the measurement date. [IFRS 13.11]	• Consider accounting policy for investments that are quoted in exchange markets, as they are no longer required to be measured at either bid (long) or ask (short), but instead will require a policy to account for them based on the point within the bid ask spread that is most representative of fair value.[IFRS 13.70] For example, if using closing price, it will need to be considered whether valuation processes are in place to identify circumstances where the close price falls outside the bid-ask spread. Furthermore, if electing close prices, there may be a measurement difference to be presented in the opening IFRS balance sheet. • For investments subject to restrictions on resale, consideration will need to be given to whether or not the restrictions arise as a result of the instrument itself (e.g. rather than through separate agreements apart from the instrument) and the impact, if any, on fair value. • Investment funds will need to determine the principal market for investments that they hold. The principal market is the market that the entity has access to that has the greatest volume and level of activity for the asset or liability, even if the prices in other markets are more advantageous. [IFRS 13.18] In addition, investments funds, particularly those which invest in non-financial assets, may need to identify potential markets and the 'highest and best use' of their specific investments in order to determine the most advantageous market for the purpose of measuring fair value. • Other considerations for investment funds applying IFRS 13 include the appropriateness of the cost approach in measuring fair value for certain unquoted securities, lack of a practical expedient to assume that the net

	Under IFRS 13, management determines fair value based on a hypothetical transaction that would take place in the principal market or, in its absence, the most advantageous market. [IFRS 13.16] The principal market is the market that the investment fund has access to that has the greatest volume and level of activity for the asset or liability, even if the prices in other markets are more advantageous. [IFRS 13.18] It is not necessary to undertake an exhaustive search of all possible markets in order to identify the principal or most advantageous market, however it should take into account all information that is readily available. In the absence of evidence to the contrary, the market in which an entity normally transacts is presumed to be the principal market or the most advantageous market in the absence of a principal market. There are limited differences (versus Section 3862) in the fair value hierarchy (IFRS 13.72), valuation techniques (IFRS 13.67) or inputs to valuation techniques (IFRS 13.69) noted. However, this standard requires enhanced disclosures, requiring both financial and non-financial instruments be presented in the fair value hierarchy. In addition, enhanced disclosures around Level 3 inputs and sensitivity amongst other items (IFRS 13.93-94).	asset value of an investment in another investment fund is representative of its fair value, and in which circumstances portfolios may be valued in aggregate rather than individual instruments themselves. • Consider evaluation of the data that will be required to provide for the enhanced disclosures (IFRS 13.93 and 13.94), which include determination of appropriate classes of assets and liabilities to be presented as well as extensive disclosure on fair value measurements, techniques, transfers between levels and sensitivity on Level 3 inputs which were not previously required.
Non-financial instruments	Investment funds may hold investments which are non-financial (e.g. investment property, commodities, etc.).	• Under IFRS, determination of which guidance applies to each type of non-financial asset is needed. For some investments, such as investment property which is specifically addressed by IAS 40, *Investment Property (IAS 40),* the analysis may be straightforward. However, for other types of non-financial assets, including many commodities, significant judgment is likely to be required. Where intermediary holding companies own title to the non-financial asset, the fund's investment in the equity instruments of the holding company would be assessed also using IFRS10 below.

TRANSITION FROM IAS 39 TO IFRS 9

IFRS 9 *Financial Instruments* replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods beginning on or after January 1st, 2018 (mandatory). The Standard includes requirements for recognition and measurement, impairment, de-recognition and general hedge accounting. In terms of investment funds, the focus of this document will be to provide guidance for the classification of financial assets and liabilities.

Classification determines how financial assets and financial liabilities are accounted for in financial statements and, in particular, how they are measured on an ongoing basis. IFRS 9 introduces a logical approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This single, principle-based approach replaces existing rule-based requirements that are complex and difficult to apply. The new model also results in a single impairment model being applied to all financial instruments removing a source of complexity associated with previous accounting requirements.

Business Model test for Investment Funds

Under IFRS 9, financial assets and financial liabilities are classified into the following three categories:

i. Amortized cost
ii. Fair value through other comprehensive income ("FVOCI")
iii. Fair value through profit or loss ("FVTPL")

The basis of classification focuses on two elements:

a) The entity's business model for managing the financial assets and financial liabilities; and
b) The contractual cash flow characteristics of the financial assets and financial liabilities.

When to use Amortized Cost?

Financial assets shall be measured at amortized cost if both of the following conditions are met:

a) The financial assets are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
b) The contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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When to use FVOCI?

Financial assets shall be measured at fair value through other comprehensive income if both of the following conditions are met:

a) The financial assets are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
b) The contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

When to use FVTPL?

Financial assets shall be measured at fair value through profit or loss **unless it is measured at amortized cost or at fair value through other comprehensive income**.

Accordingly, if an instrument does not meet the first two criteria it will automatically be classified as FVTPL. Under the new model, FVTPL is the residual category. Financial assets should be classified as FVTPL if they do not meet the criteria of FVOCI or amortized cost.

Business Model Assessment for Investment Funds

Considerations in determining the appropriate business model:

The activities applied in managing financial assets within investments funds closely match with the last category of business model noted above (other business models)[1].

B4.1.5 Financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets (but see also paragraph 5.7.5).

One business model that results in measurement at fair value through profit or loss is one in which an entity:

- Manages the financial assets with the objective of realizing cash flows through the sale of the assets.
- Makes decisions based on the assets' fair values and manages the assets to realize those fair values.

In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a business model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the business model's objective; instead, it is incidental to it.

B4.1.6 A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 4.2.2(b)) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the business model's objective. Consequently, such portfolios of financial assets must be measured at fair value through profit or loss.

It is expected that most Canadian investment funds will fall within this business model. IFRS 9 requires that all financial assets are subsequently measured at amortized cost, FVOCI or FVTPL based on the business model for managing the financial assets and their contractual cash flow characteristics.

The business model is determined by the entity’s key management personnel in the way that assets are managed and their performance is reported to them. The business model applied in managing the assets in investment funds does not typically meet the criteria described in Appendix A, for classification at amortized cost or fair value through other comprehensive income. An investment fund’s main objective in its buying and selling of investments is to realize their fair values. The sales are integral in managing the assets in the portfolio, collecting cash flows is incidental.

[1] IFRS 9 Appendix B – B4.1.5-B4.1.6 where the financial assets are measured at FVTPL

The table[2] below summarizes the key considerations in the business model assessment:

IFRS 9 business model classifications – key considerations

	Holding to collect contractual cash flows	Holding to collect contractual cash flows and sell	Other
Over-arching objective	Collecting cash flows is integral, sales are incidental	Collecting cash flows and selling assets are both integral	Sales are integral, collecting cash flows is incidental
Examples of why sales happen in each category	Sales are made in response to increase in asset's credit risk or to manage credit concentration risk	Sales are made as part of managing everyday liquidity needs, maintaining a particular interest yield profile or matching the duration of financial assets and liabilities	Sales are made within a program of active buying and selling to realize fair values
Illustrative examples in IFRS 9	IFRS 9, B4.1.4	IFRS 9, B4.1.4C	IFRS 9, B4.1.5
Resulting Treatment	**Amortized cost**	**FVOCI**	**FVTPL**

IFRS 9 states that identifying business models is a matter of fact that is typically observable through an entity's activities, not merely an assertion. Relevant evidence that entities should consider include:

- How information about financial assets and their performance is evaluated by the entity's key management personnel.
- The risks that affect the performance of the group and the way which those risks are managed.
- How managers are compensated (e.g., whether the compensation is based on the fair value of the assets or the contractual cash flows that are collected).

Investment funds generally manage financial assets and financial liabilities as a group. The performance is evaluated on a fair value basis in adherence to a documented investment objective and risk profile. The information about the investment fund's performance is provided both internally on that basis to the entity's key management personnel and externally.

Therefore, assets held in investment funds must be classified and measured at fair value through profit or loss in accordance with IFRS 9.

Under IAS 39, assets held as part of a group that were managed and their performance evaluated on a fair value basis were eligible to be classified at FVTPL, but this classification was not mandatory. Under the new requirements, these financial assets are required to be classified at FVTPL. For most investment funds the business model is to achieve overall performance, which may include an income component that is only incidental.

For additional information on alternative approaches and areas to consider in assessing business models, see Appendix C.

[2] Courtesy PricewaterhouseCoopers LLP

Money Market Funds – investment assets and liabilities designated to FVTPL

Liability Method under IAS 32

Many money market funds have their units classified as liabilities pursuant to the IAS 32 requirements (as outlined in the IFIC toolkit). As a result, each Fund's obligation for net assets attributable to holders of redeemable units represents a financial liability and is presented at the redemption amount. The fund's obligation for net assets attributable to securityholders is measured at FVTPL, with fair value being the redemption amount as of the reporting date.

Business Models for Money Market Funds

Most money market funds' investment objective is to provide maximum income while preserving capital and liquidity by primarily investing in short term debt instruments. These funds have to invest additional contributions and fund redemptions. In addition, trading may also occur to actively manage the yield, credit risk and liquidity. Based on the trading activity of the fund and other relevant considerations as noted above it may be categorized under any of the three business models*:*

1. A business model whose objective is to hold assets in order to collect contractual cash flows
2. A business model whose objective is achieved by both collecting contractual cash flows and selling financial assets
3. Other Business Model - Financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Fair Value Designation to eliminate Accounting Mismatch

If the business model of the money market fund is 1 or 2 above resulting in either amortized cost or FVOCI for investments held but the fund's units are classified as financial liabilities and measured at FVTPL, the fund may be able to use the Fair value designation option under IFRS 9 and have these financial assets classified as FVTPL.

This option is available to eliminate or significantly reduce a measurement or recognition inconsistency, sometimes known as an 'accounting mismatch', that otherwise would arise from measuring assets or liabilities or recognizing the gains and losses on different bases.

Designation eliminates or significantly reduces an accounting mismatch

B4.1.29 Measurement of a financial asset or financial liability and classification of recognized changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as subsequently measured at fair value through profit or loss and a liability the entity considers related would be subsequently measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through profit or loss.

For money market funds with units classified as equity there is no ability to designate by eliminating the accounting mismatch. In such cases such funds would need to fall into Business Model 3 to get to FVTPL classification.

Other Considerations

The situations presented in this paper may not be applicable to all Fund types. Management should consider their particular circumstances and determine other factors they may need to put into consideration before determining the applicability of the positions here to each of their funds.

Disclosure Considerations for IFRS 9 Transition

Additional transition notes are required as at the transition date, aimed principally at reconciling the opening balances of the former categories of financial assets and financial liabilities to the new categories under IFRS 9. These notes are also aimed at identifying the categories of financial assets and financial liabilities under IFRS 9, and a description of how the classification requirements in IFRS 9 were applied to those financial assets and financial liabilities whose classification has changed as a result of applying IFRS 9.

Different Categorization Scenarios and suggested draft Transition Disclosure Notes

Expected financial assets and financial liabilities categorization scenarios are below:

- Scenario 1: All financial assets and financial liabilities are in one and the same category under IAS 39 and upon transition to IFRS 9 – consider note 1 below;
- Scenario 2: There are differences in the classification of financial assets and financial liabilities between IAS 39 and under IFRS 9, but there were no changes in measurement attributes in any of the categories upon transition to IFRS 9 – consider note 2 below; and,
- Scenario 3: There are differences in the classification of financial assets and financial liabilities between IAS 39 and under IFRS 9, and there were change(s) in measurement attributes in any of the categories upon transition to IFRS 9 – consider note 3 below.

IFRS 9 Transition Notes (preamble – general note):

Effective XXXX, the fund adopted IFRS 9 Financial Instruments. The new standard requires assets to be carried at amortized cost, fair value, with changes in fair value recognized in profit and loss (FVTPL) or fair value through other comprehensive income (FVOCI) based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

Assessment and decision on the business model approach used is an accounting judgement.

The classification and measurement of liabilities remains generally unchanged with the exception of liabilities recorded at FVTPL. For these liabilities, fair value changes attributable to changes in the entity's own credit risk are to be presented in other comprehensive income unless they affect amounts recorded in income.

(Depending on your scenario, additional note disclosures below may be applicable to the above general note)

Scenario 1: No Changes in Classification upon transition

Upon transition to IFRS 9, the Fund's financial assets and financial liabilities previously classified as fair value through profit and loss (FVTPL) under IAS39 continued to be categorized as fair value through profit and loss (or any other single category of classification arrived at). There were no changes in the measurement attributes for any of the financial assets and financial liabilities upon transition to IFRS 9.

Scenario 2: Changes in Classification / No change in measurement attributes

Upon transition to IFRS 9, certain financial assets and liabilities were categorized as amortized cost and the Fund's other financial assets and financial liabilities were classified as FVTPL (or amortized cost, or FVOCI, as the case may be – or a combination of any of the categories). This classification differs from the classification under the previous IAS 39, therefore there were changes in categorization of certain financial assets (and financial liabilities) upon transition to IFRS 9.

However, there were no changes in the measurement attributes for any of the financial assets and financial liabilities upon transition to IFRS 9. The table below (or note XX, as the case may be) shows a reconciliation of the financial assets (and financial liabilities) balances as at January 1, 2018, IFRS 9 transition date:

Financial assets	FVTPL* $	Amortized Cost $	Held-to-Maturity $	Loans and Receivables $	Total $
Opening balance – under IAS 39	**1,200**		**500**	**70**	**1,770**
On the basis of change from IAS 39 to IFRS 9:					
- reclassification of investments to FVTPL√	350		(350)		-
- reclassification of debt securities from held-to-maturity√	150		(150)		-
- reclassification of loans and receivables√	20	50		(70)	-
Total change on transition to IFRS	520	50	(500)	(70)	-
Opening balance – under IFRS 9	**1,720**	**50**	**-**	**-**	**1,770**

(consider similar table for financial liabilities, as applicable)

* Under IAS 39 this category was made up of $750 Held for Trading and $450 designated as FVTPL sub-categories. Under IFRS 9, such sub-categorization of FVTPL is no longer applicable / required. [Note that if FVTPL under IFRS 9 was from fair value option used due to accounting mismatch, separate disclosure would continue to be required in line with IFRS 7, that requires separate disclosure of financial instruments that must be at FVTPL from those which are elected at FVTPL (on both the statement of financial position and statement of comprehensive income)]

√ Include here a description of how the classification requirements in IFRS 9 were applied to those financial assets and financial liabilities whose classification has changed as a result of applying IFRS 9 (describe with footnote for each reclassification changes noted in the table above).

√ This table should conform to the presentation of the IAS 39 table previously disclosed in the notes.

Scenario 3: Changes in Classification and Measurement Attributes upon transition

Upon transition to IFRS 9 (from IAS 39), the Fund's financial assets and financial liabilities were classified as FVTPL (or amortized cost, or FVOCI, as the case may be – or a combination of any of the categories). This classification differs from the classification under IAS 39, as a result there were changes in the disclosure of categories of financial assets and financial liabilities upon transition to IFRS 9.

In addition, there were change(s) in the measurement attributes for some of the financial assets (and or financial liabilities) upon transition to IFRS 9. The table below (or note XX, as the case may be) shows a reconciliation of the financial assets (and financial liabilities) balances as at January 1, 2018, IFRS 9 transition date:

Financial assets	FVTPL* $	Held-to-Maturity $	Amortized Cost $	Loans and Receivables $	Total $
Opening balance – under IAS 39	**1,200**	**500**	**-**	**70**	**1,770**
On the basis of change from IAS 39 to IFRS 9:					
- reclassification of investments to FVTPL√	500	(500)			-
- reclassification of debt securities from loans and Receivables √	50			(50)	-
- reclassification of loans and receivables√			20	(20)	-
Sub-total – changes due to transition	550	(500)	20	(70)	-
On the basis of change in measurement attribute on transition to IFRS 9 – e.g.:					
- changes in amortized cost calculation factors ₸	(20)				(20)
- change in other valuation factors ₸	50				50
Sub-total changes due to change in measurement attribute(s) upon transition	30	-	-	-	30
Total change on transition to IFRS 9	580	(500)	20	(70)	30
Opening balance – under IFRS 9	**1,780**	**-**	**20**	**-**	**1,800**

(Consider similar table for financial liabilities, as applicable)

* Under IAS 39 this category was made up of $750 Held for Trading and $450 designated as FVTPL sub-categories. Under IFRS 9, such sub-categorization of FVTPL is no longer applicable / required. [Note that if FVTPL under IFRS 9 was from fair value option used due to accounting mismatch, separate disclosure would be required in line with IFRS 7, that requires separate disclosure of financial instruments that must be at FVTPL from those which are elected at FVTPL (on both the statement of financial position and statement of comprehensive income).]

√ Include here a description of how the classification requirements in IFRS 9 were applied to those financial assets and financial liabilities whose classification has changed as a result of applying IFRS 9 (describe with footnote for each reclassification changes noted in the table above.

₸ Include here a footnote of the measurement attribute that changed and the changes (e.g., effective interest yield changed from XX% to XY% on transition to IFRS 9 – as applicable).

Sample of updated Significant Accounting Policies note

The following are examples of possible updated Significant Accounting Policy notes to reflect the adoption/transition to IFRS 9:

SIGNIFICANT ACCOUNTING POLICIES

(a) Financial Instruments

Financial instruments include financial assets and liabilities such as debt and equity securities, open-ended investment funds and derivatives, cash and other receivable and payables. The Fund classifies and measures financial instruments in accordance with IFRS 9 Financial Instruments (IFRS 9). Upon initial recognition, financial assets and financial liabilities are classified as fair value through profit or loss (FVTPL).

Note: The last statement above is generic and may not be true in all situations – possible variations from this general position should be considered for different Fund types / situation, as applicable.

All financial assets and liabilities are recognized in the Statements of Financial Position when the Fund becomes a party to the contractual requirements of the instrument. Financial instruments are derecognized when the right to receive cash flows from the instrument has expired or the Fund has transferred substantially all risks and rewards of ownership. As such, investment purchase and sale transactions are recorded as of the trade date.

Financial assets and financial liabilities are subsequently measured as FVTPL with changes in fair value recognized in the Statements of Comprehensive Income.

(extracts from Investor Group's publicly available financial statement; Investor Group early adopted IFRS 9)

Additional Considerations

Derivatives disclosure

Under IFRS 9, derivatives are classified as FVTPL like other financial assets and liabilities, so there is no requirement to present separately the different component amounts on the Statement of Comprehensive Income as they fall within the same classification; this is a change from the requirement under IAS 39 where derivatives were classified as Held for Trading.

However, CSA regulatory requirements under NI 81-106 prescribe the individual line items that are required to be disclosed which includes separate disclosure for derivatives.

Disclosures which can be eliminated

Previously IAS 39 required investment funds to disclose a more detailed break-out of categories either in a table or on a qualitative basis. This will no longer be required unless the fair value option is utilized.

Samples

IAS 39 Table – Financial Instruments by Category (Financial Assets/Liabilities)

Financial Assets As at December 31, 2016 and June, 30, 2016	HFT ($000)	At FVTPL ($000)	Total ($000)	At amortized cost ($000)	Total ($000)
Assets					
Investments	-	236,827	236,827 $	-	236,827
Cash			-	27,304	27,304
Amount due from pending securities sales			-	-	-
Accrued revenue			-	2,662	2,662
Other receivable			-	-	-
Reedemable unit subscriptions receivable			-	106	106
Derivative financial instruments					
Unrealized gain on foreign currency forward contracts	905		905		905
Options	-		-		-
Unrealized gain on futures contracts	-		-		-
Total	905	236,827	237,732	30,072	267,804

Net Gain Loss Classification table (Segregating the HFT & Designated)

	Net gain (loss) ($000)	
Category	December 31, 2016	December 31, 2015
Financial assets and liabilities at FVTPL:		
Held-for-trading	(2,678)	(2,637)
Designated at inception	730	16,020
Total	(1,948)	13,383

GUIDANCE ON IFRS CLASSIFICATION & PRESENTATION OF PUTTABLE SHARES OR UNITS

Relevant IFRS: IAS 32 Financial Instruments: Presentation

Overview

Canadian investment funds issue shares or units (referred to as either "units" or "shares" interchangeably in this document) with unique, entity-specific characteristics which represent the investors' ownership interest. Under Canadian GAAP Part V, investment fund units that are redeemable are typically classified as equity in accordance with CICA Handbook section 3863 or EIC-149 *Accounting for Retractable or Mandatorily Redeemable Shares*.

The focus of this portion of the toolkit is to discuss certain issues with regard to classification and presentation of units as financial liabilities or equity. Specifically, the focus of this section of the document is the exception in IAS 32 paragraphs 16A and 16B which requires puttable units that are financial liabilities by definition to be presented as equity if each of the criteria in these paragraphs are met. This section of the toolkit does not address any of the other aspects of IAS 32 that may bear on the classification of fund units (for example, those provisions of IAS 32 that would bear on limited life entities).

Approach to initial classification

For Canadian investment funds, applying IAS 32 to puttable units is a multistep process that in general considers the puttable units of a fund in the following manner:

1) Do the units meet the general definitions to qualify as a "financial liability" or as "equity" under IAS 32?
2) Do the units include contractual obligations for the fund to repurchase or redeem the units for cash (or another financial asset) upon exercise by the unitholder? (i.e. do the units qualify as "puttable instruments" under IAS 32)
3) If it is determined that the units qualify as puttable instruments, do the units meet <u>all</u> the criteria under IAS 32 requiring the units to be presented as equity by exception?

Given the diversity of characteristics from fund to fund and between fund managers, analysis is required to determine how each fund should classify and present its units under IFRS.

Are the units of the investment fund a "financial liability" or "equity"?

Determining whether the units of the fund meet the general definitions to qualify as a "financial liability" or as "equity" requires consideration of the features of the fund's units against the general definitions contained in IAS 32.11, and the other guidance contained within IAS 32. One of the key features in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder), or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Investment funds typically issue units that are redeemable at the option of the holder for cash as per the contractual terms of the instrument (for example as may be set out in the fund's Declaration of Trust (DOT) or other relevant documents). These fund units will meet the definition of a financial liability as they contain a contractual obligation of the issuer of the financial instruments to deliver cash to the holder.

It is important to note that the IAS 32 definition of a financial liability focuses on contractual obligations. The language in the documents that establish the contractual features of the units (for example, the DOT or other relevant documents) must be assessed to determine whether the units are financial liabilities. Economic compulsion or fiduciary obligations are not contractual obligations and generally do not impact the determination of whether an instrument is a financial liability.

Do the units qualify as "puttable instruments" under IAS 32?

As these fund units give the holder the right to put the instrument back to the issuer for cash, they are puttable instruments as defined in IAS 32 and may qualify for and require presentation as equity by exception if certain specific criteria are <u>all</u> satisfied. It is important to note that the application of the guidance in IAS 32 is not always straightforward, especially for financial instruments that contain multiple features, therefore each fund must refer back to the guidance in IAS 32 and develop its own analysis.

In general, it is expected that most funds will begin the analysis by identifying that the units that are redeemable at the option of the holder for cash as per the contractual terms of the instrument constitute financial liabilities. The balance of the discussion in this toolkit assumes this is the case.

However, as these units are puttable instruments since they can be redeemed at the option of the unitholders, it is necessary to consider the following question - **Do the units meet <u>all</u> the criteria under IAS 32.16A and .16B which would require the units to be classified as equity by exception?** The balance of the discussion in this toolkit focuses primarily on this question.

IAS 32.16A and .16B state that:

16A. A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. ***<u>As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features</u>****:*

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the entity's net assets on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation, and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.

(d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

16B. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognized and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

(b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16A that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

It is important to note that it is not an option to present a puttable unit as either a financial liability or equity. If a puttable unit has **all** the features noted in paragraph 16A and 16B above, even though it meets the definition of a financial liability it must be presented as equity. Therefore, the contractual features of the puttable units issued by each fund must be assessed against the criteria noted in paragraphs 16A and 16B above for the purpose of determining the required financial statement presentation on the transition date as well as on an ongoing basis.

It is important to note that the presentation of puttable units as equity is required when all of the criteria in paragraphs 16A and 16B are met. As a result, if one of the criteria is violated puttable instruments will not be presented as equity. The features in paragraphs 16A and 16B above that are most likely to not be met in the case of the more typical puttable units issued by a typical investment fund in Canada are those in paragraphs 16A (b), (c) and (d) above.

The following are some, but by no means all, factors to consider in analyzing the criteria in paragraphs 16A and 16B when determining how to present puttable units. As this list of factors is not exhaustive, a detailed analysis will need to be done on a fund by fund basis or fund group by fund group basis to determine whether each specific class of units are financial liabilities or equity by definition and for puttable units that are financial liabilities, whether all criteria under IAS 32.16A and .16B are met for such puttable instruments to be presented as equity.

Funds with multiple series of units

For a fund with more than one issued and outstanding series of units and where those series of units are all equally subordinate and together represent the most subordinate of all classes of instruments, it is very often the case that the features of each series will be different (for example, fee rates for expenses charged directly by a fund for each series may be different under the contractual terms of the units). In this case, this would appear to violate the criterion under paragraph 16A (c) as the features of each fund unit in the class of instruments that is the most subordinate of all classes of instruments are not identical. In this case, the puttable units which are financial liabilities by definition will be presented as such even when they are in the most subordinate class of instruments because the criterion in paragraph 16A(c) is not met. It should be noted that in some cases there may be separate agreements which in substance form additional contractual terms of the units themselves. Judgment will need to be applied to determine whether or how these outside agreements are factored into the analysis and legal interpretation may be necessary.

It is important to note that it is not appropriate to assume that the puttable units of a fund with multiple series of units will automatically violate the identical features criterion under paragraph 16A(c) resulting in those series of puttable units that are equally subordinate and together represent the most subordinate of all classes of instruments issued by the fund being presented as liabilities. An analysis must be performed to assess whether all features attached to each unit in the most subordinate class of instruments are identical or not. If identical, the other criteria in paragraph 16A and 16B must still be analyzed.

In addition, the fund may have other units that are more subordinate than its puttable units which may need to be presented as equity. An analysis of each class of units against the definitions of financial liability and equity and the criteria for presentation as equity by exception in IAS 32 is required.

Funds that are share classes of a mutual fund corporation

For funds that are structured as share classes of a mutual fund corporation, financial statements are often prepared for each separate share class within the mutual fund corporation and the classification and presentation of shares as financial liabilities or equity in each of these financial statements is necessary. In making this assessment, one might first consider the nature of the reporting entity. Specifically, is the specific share class an entity in its own right or is it more akin to a carve out from the larger mutual fund corporation entity? While there is limited guidance within IFRS as to what constitutes an entity, one reference point to consider is the deemed separate entity or "silo" concept within IFRS 10.

Under paragraph B77 of IFRS 10:

An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied:

> *Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets*

> *can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.*

While each share class within a mutual fund corporation has its own portfolio of assets, all share classes within a mutual fund corporation in Canada typically are legally responsible for the liabilities of the mutual fund corporation as a whole, which means that if one share class is in a negative net assets position, the other share classes are responsible for the liabilities of that share class. If one were to draw an analogy to paragraph B77 of IFRS 10 above, the assets and liabilities of each share class are not ring-fenced from the overall mutual fund corporation and therefore would not be considered a deemed separate entity or "silo" per IFRS 10. As such, one might take the view that each share class is not its own entity, but instead a carve-out from the mutual fund corporation. If at the mutual fund corporation level the share classes otherwise meet the definition of financial liability and do not satisfy all the criteria for presentation as equity under paragraphs 16A and 16B of IAS 32 (perhaps for the reasons noted above in the discussion of funds with multiple series of units), one might take the view that this presentation is appropriately reflected in the separate class financial statements on the basis that they are a carve out from the larger mutual fund corporation rather than being a separate entity in their own right.

Under this view, to the extent that the assets and liabilities within each share class are fully ring-fenced from the overall mutual fund corporation and may therefore be considered a deemed separate entity by analogy to IFRS 10, the classification and presentation of shares as financial liabilities or equity under IAS 32 may need to be assessed separately at the share class deemed separate entity level which could result in a different classification and presentation.

As the legal structure of each mutual fund corporation may be different, each fund must carefully consider its own specific facts and circumstances and conduct a thorough analysis against the definitions and criteria in IAS 32.

Funds with founders' shares or units

If a fund has a separate share or unit class from the puttable shares or units of the fund, for example, founders' shares, that are more subordinate than the puttable shares or units (see paragraph 16A(b) for a description of what constitutes a share or unit class that is subordinate to all other classes of instruments), then the puttable shares or units of the fund are not considered the most subordinate class, which violates the criteria under paragraph 16A(b). As a result, the classification of the puttable shares or units will remain as financial liabilities. Note: an assessment will need to be made as to whether the founders' shares meet the definition of a financial liability or equity under IAS 32 and if a financial liability whether they are required to be presented as equity by exception.

Distribution requirements

If under the contractual terms of a fund's puttable units a fund has a contractual obligation to distribute cash or another financial asset to the holders of such units, this will violate paragraph 16A (d). As a result, these puttable units that are financial liabilities by definition will be presented as such.

The language in the documents that establish the contractual features of the units (for example, the DOT or other relevant documents) must be assessed to determine whether the language constitutes a "contractual obligation". Economic compulsion or a fiduciary obligation to distribute cash or another financial asset is not a contractual obligation. It is important to consider the totality of the contractual features of the units in order to determine whether a contractual obligation to distribute exists or not. It may be necessary to consult with legal counsel on whether the contractual features of the units establish such a "contractual obligation".

For investment funds in Canada, it is very common for distributions to be reinvested in units of the fund. Consider a fund with a single class of units that represents the most subordinate interest in the fund. A distribution pro-rata to unitholders in additional units rather than cash or other financial assets does not result in an outflow of resources from the fund and should not substantively effect the economic position of the unitholders in the fund. The unitholders will be in substantively the same position before and after distributions are paid in units similar to a stock dividend or stock split. In this circumstance, if it is at the sole and absolute discretion of the fund to distribute in cash or in additional units of the fund in any and all circumstances, it may be that the fund does not have a contractual obligation to distribute cash or other financial assets as contemplated by paragraph 16A(d) and the criterion in paragraph 16A(d) may not be violated.

The contractual terms of fund units as they relate to distributions can vary significantly for each fund or for each fund group and for each class of units within a fund, therefore a careful reading of the all of the contractual terms in totality is a necessity to assess whether the fund does in fact have the absolute discretion to distribute in additional units in any and all circumstances. Again, it may be necessary to consult with legal counsel to determine whether this is the case.

Some other factors to consider as they relate to distribution include but are not limited to:

Is the option to distribute in units or in cash with the fund or with the unitholders? If the fund has a contractual obligation to make distributions of future earnings to puttable unitholders but the holders of a fund unit may choose whether his or her distributions were to be paid in cash or additional units and this discretion does not reside with the fund, then paragraph 16A(d) is violated.

If the fund has the discretion to pay contractually required distributions in additional units, are there any circumstances where unit holders have the right to demand that such distributions be paid in cash? If the fund does not have the right to pay contractually required distributions in additional units in any and all circumstances, paragraph 16A(d) is violated.

Is there an overriding clause within the contractual terms of the units that give unitholders the legal right to enforce payment of any amount to be distributed or payable at the time such amount is due and payable? Legal advice may need to be sought as to whether the enforcement of payment means cash payment or if it can be payment in units at the fund's discretion. If the unitholders have the legal right to enforce payment in cash, then paragraph 16A(d) would appear to be violated.

Is there an overriding clause within the contractual terms of the units that give the fund discretion to distribute or discretion to distribute in kind in any and all circumstances? It is important to consider all the contractual terms of the units in totality when assessing the paragraph 16A(d) criterion. It is also important to distinguish contractual terms from economic compulsion or a fiduciary obligation as it is only contractual terms that are relevant for purposes of the paragraph 16A(d) criterion.

Certain other features

The working group is aware that the industry has raised other characteristics of fund units that require analysis as to whether they violate the identical features requirement in paragraph 16A(c). Some of these include:

- Management fee or other fee rebates
- Different redemption features or terms that result in participation in the entity's net assets on a basis other than pro rata (e.g. in the case of ETFs where the option to redeem at 100% of NAV may only be available to units held by designated brokers while all other unitholders can only redeem their units at 95% of the last traded price)
- Different voting rights

It is important to determine whether these features represent features of the instrument and if so whether the features of all of the units in the most subordinate class of units are identical. As it is not clear whether some of the above characteristics will result in different features for each unit of a fund that is in a class of instruments that is subordinate to all other classes of instruments, further analysis will need to be made as to whether the identical features requirement in paragraph 16A(c) is met or not based on the specific facts and circumstances.

<u>Puttable shares or units presented as equity</u>

If the fund's puttable units meet all criteria under IAS 32.16A and .16B, then the fund units are presented as equity in accordance with IAS 32. In this case, even though the fund units are presented as equity under both Canadian GAAP Part V and IFRS, there will still be financial statement presentation differences as a result of the fund units being classified as equity under IFRS. One such difference is that under Canadian GAAP Part V, open-ended investment companies are exempted from having to present a statement of changes in equity. However, under IFRS, there is no such exemption. Therefore, a fund that is required to classify or present its units as equity will be required to present a statement of changes in equity and a reconciliation of the different components of equity in accordance with IAS 1. This implies that equity will need to be bifurcated between cost and retained earnings at a minimum on an ongoing basis, as well as retroactively for the purpose of the opening statement of financial position. Some of the challenges that this may pose for investment funds on conversion to IFRS include:

- The information required to bifurcate equity into the different components is generally not readily available for most investment funds in Canada as this was not previously required under Canadian GAAP Part V.
- Having both equity and liability classification for funds within a fund group and across different fund groups will decrease the comparability of financial statements as the presentation will be different under each classification.

Funds are also reminded of paragraph 96C of IAS 32 which indicates that although puttable units may be presented as equity by exception when the criteria in paragraphs 16A and 16B are met, they are not considered equity for purposes of applying certain other IFRSs (for example, IFRS 2 Share-based Payment and IAS 33 Earnings Per Share). Funds are encouraged to carefully look at this guidance and consider additional note disclosure explanations in the financial statements when EPS is disclosed in the financial statements (because of NI 81-106 requirements).

Funds are encouraged to refer to the illustrative examples that accompany IAS 32 that illustrate certain approaches to financial statement presentation for mutual funds whose share capital is not equity. In addition, your qualified professional advisor may have illustrative fund financial statements for both the circumstance where fund units are liabilities and the circumstance where fund units are presented as equity. Such illustrative financial statements may be available from your qualified professional advisor either on their website or by request.

GUIDANCE ON IFRS CONSOLIDATION FOR INVESTMENT FUNDS

Relevant IFRS: 10

Overview

A significant concern for Canadian investment funds upon adoption of IFRS was that they would be required to consolidate subsidiaries instead of accounting for them at fair value as is done in most cases under Accounting Guideline 18 ("AcG-18"). With recent amendments to IFRS 10 *Consolidated Financial Statements* most Canadian investment funds should be able to continue to account for those subsidiaries at fair value. It should be noted that, for most retail investment funds, it is unlikely that there will be controlled subsidiary investments, except potentially in fund of funds structures. As a result, IFRS 10 as amended only applies to those funds that have controlled subsidiaries. However, it may be important to make a determination that the fund is an investment entity even if it has no controlled subsidiaries in order to be eligible for the IFRS 12 paragraph 21A exemption from providing summarized financial information for associates and joint ventures (refer also to the presentation and disclosure section). This is an area that is still being assessed globally.

These amendments are summarized below:

Considerations	Guidance
Canadian investment funds will first need to determine if they control an investment under IFRS 10. **This determination can be quite complicated and is not as simple as owning more than 50% of the equity instruments of an entity**.	An investment fund controls an investee if and only if the fund has all the following: (a) **power** over the investee (see paragraphs 10–14 of IFRS 10); (b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and (c) the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18). Power arises from existing rights that give the current ability to direct *relevant activities* (IFRS 10.10)
Once the investment fund determines that it controls an investment (whether the investment is an operating enterprise or another fund that holds investments) it will then look to the amendments to IFRS 10 to determine if it is an "investment entity".	IFRS 10.27 states that an investment entity is an entity that: **(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;** **(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and** **(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.** Paragraphs B85A–B85M provide related application guidance. In addition, IFRS 10.28 states that an entity shall consider whether it has the typical characteristics of an investment entity: (a) it has more than one investment (see paragraphs B85O–B85P); (b) it has more than one investor (see paragraphs

Considerations	Guidance
	B85Q–B85S); (c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and (d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W). The standard further states that the absence of any of the typical characteristics above does not necessarily disqualify an entity from being classified as an investment entity. However, it is unlikely that an entity could be considered an investment entity without possessing any of the typical characteristics. It is also important to note that these characteristics are not expressed as criteria to recognize practical considerations over the investment entity lifecycle (e.g. a private equity fund may start with one investment) and to accommodate different structures (e.g. Canadian segregated and pension funds may have different ownership interests). Note: disclosures are required regarding the judgements made in this determination.
If the investment fund determines that it is an investment entity under IFRS 10, then it doesn't consolidate its subsidiary(ies) (unless it is a service entity) but rather accounts for its investment in that subsidiary at fair value through profit or loss in accordance with IFRS 9 or IAS 39 (i.e. whichever financial instrument standard the fund is currently applying). **Thus, the consolidation exception is mandatory.**	Paragraph B85L also requires an investment entity to measure all of its other investment assets at fair value. Non-investment assets and liabilities can be measured at other than fair value. There is one type of subsidiary that an investment entity is required to consolidate ("service entities") (IFRS 10.32). **It is our suggestion that if you think you have this situation, you consult your advisors as this is a complicated and evolving issue and a number of different scenarios are being discussed globally**. **Another matter getting global attention is what constitutes a "blocker company" (as described in BC272) so we would suggest you also consult with your advisors if you employ these entities.** In addition, the consolidation exception doesn't apply to a non-investment entity parent of an investment entity. **This is one of the differences between IFRS 10 and the new U.S. standard for investment entities**. We expect that this scenario will have the most impact in Canada on large banks and insurance companies but could also be an issue for private equity and hedge fund managers. This scenario isn't discussed further in this document as it won't likely impact retail investment funds.

The application guidance contained in paragraphs B85A to M is important to assessing whether an investment fund would be considered an investment entity.	Canadian investment funds currently applying AcG-18 should read the application guidance carefully and we expect that, among other paragraphs, B85B may be challenging to meet for certain real estate funds (e.g. those involved with property management). Also, Canadian private equity funds who adopt IFRS and pension funds should focus on B85J. The amendments to IFRS 10 do allow an investment entity to provide management services and strategic advice to an investee as well as provide financial support to an investee, such as a loan, capital commitment or guarantee (discussed in B85D). The investment services cannot represent a separate substantial business activity or a separate substantial source of income.
Investment entities will be required to make certain disclosures under IFRS 12 *Disclosure of interests in other entities*.	In addition to the requirements of IFRS 12 applicable to all entities, there are also investment entities specific requirements contained in paragraphs 9A-B and 19A-G. The requirements are contained in paragraphs 9A-B and 19A-G of IFRS 12 although it is expected that paragraph 19A-G will have more impact on Canadian investment funds (paragraph 19A-G effectively requires a narrative describing each subsidiary).

GUIDANCE ON IFRS PRESENTATION & DISCLOSURE FOR INVESTMENT FUNDS

Overview

Under IFRS, IAS 1 *Presentation of Financial Statements* sets out the overall presentation standards for financial statements prepared under IFRS. In addition, Part 3 of National Instrument 81-106 sets out a number of presentation and disclosure requirements prescribed by securities regulators. This National Instrument was amended and released on October 3, 2013.

Another important reference source under IFRS for the format of financial statements for mutual funds and other investment companies can be found in Examples 7 and 8 in the Implementation Examples to IAS 32 *Financial Instruments: Presentation* (see paragraphs IAS 32.IE32 and IE 33.) Example 7 provides a sample format for entities with no equity because the shares or units are classified as liabilities, while Example 8 shows an entity with some or all of the issued puttable instruments and/or permanent capital such as founders shares reported as equity. In addition, IAS 7 *Statement of Cash Flows* provides some sample statements of cash flows. Beyond these standards, most IFRS standards provide specific disclosure requirements. For example, IFRS 7 *Financial Instruments: Disclosure* sets out disclosure requirements related to financial instruments and IFRS 13 *Fair Value Measurement* sets out disclosure requirements for items recorded or disclosed at fair value.

For first time adopters of IFRS, IFRS 1 *First Time Adoption of IFRS* sets out the disclosures to be provided for annual and interim periods in the year of adoption.

The discussion below provides some considerations for each of the primary financial statements: the statement of financial position, the statement of comprehensive income, the statement of changes in equity, and the statement of cash flows. The discussion also includes some other financial reporting matters. However, it should be noted that reading this summary is not a substitute for reading the standards themselves.

Statement of Financial Position

As noted above, Examples 7 and 8 in IAS 32 provide some sample formats for the statement of financial position, depending on whether the entity's units are all reported as liabilities or not (i.e., whether the entity has any accounting equity). In addition, IAS 1 sets out the minimum line items that should appear in the statement of financial position and discusses classification of assets and liabilities on a current/non-current basis or in order of liquidity.

IFRS 7 discusses presentation and disclosure requirements related to financial instruments. Information about financial instruments should be presented, either on the face of the statement of financial position or in the notes, in a way that makes it clear how financial instruments have been classified under the requirements of IAS 39 *Financial Instruments* (e.g., financial instruments that are required to be classified as held for trading versus those that are optionally designated at fair value through profit and loss or classified in the other relevant categories.) or IFRS 9 if early adopted.

Reference to the revised version of NI 81-106 released on October 3, 2013 should be made to determine if additional line items are required by the Canadian Securities Administrators.

Reference to the Canadian Securities Administrators Staff Notice 52-306 *Non-GAAP Financial Measures and Additional GAAP Measures* should also be made if additional sub-totals are added to the statement of financial position (or any other financial statement or note) in accordance with IAS 1.55 which permits the inclusion of additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

Statement of Comprehensive Income

As for the statement of financial position, Examples 7 and 8 in IAS 32 provide sample statements of comprehensive income for entities without or with equity. IAS 1 sets out the minimum line items to be presented in a statement of comprehensive income under IFRS and discusses requirements to present and/or disclose expenses by function versus nature. Investment entities with available for sale investments, under IAS 39, or other sources of other comprehensive income will need to refer to IAS 1 for guidance on the different approaches to presenting other comprehensive income.

IFRS 7 sets out presentation requirements for income, gains and losses associated with financial instruments. Interest income is to be measured using the effective interest method. However, presentation of interest income is only required under IFRS 7 for those instruments not recorded at fair value through profit and loss. To the extent interest income is separately presented related to investments that are held for trading or have been designated as at fair value through profit and loss, interest income would be calculated using the effective interest method.

Another item that may require some specific consideration under IFRS is withholding taxes. Such amounts should not be reported as a reduction of revenue and instead this is an income tax expense.

In Canada, mutual fund trusts are not taxed on income earned in a taxation year, to the extent that such income has been distributed or is payable to unitholders prior to the end of the taxation year. Typically, the declaration of trust requires that the mutual fund trust distribute sufficient income to reduce any taxable income to nil, and mandates an automatic distribution for any remaining undistributed taxable income at 11:59pm on the last day of the taxation year. As a result, there is generally little possibility of the trust being taxable on ordinary income under Part I of the Income Tax Act.

Under Canadian GAAP, investment funds previously applied the guidance of CICA 3465, (CICA 3465), which stated that “Taxes related to distributions or future distributions should be given the same accounting treatment as the distributions.” [CICA 3465.83] However, EIC 107, Application of CICA 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts (EIC 107), stated that “a tax deduction received by a trust for distributions to unitholders represents, in substance, an exemption from taxation of an equivalent amount of the trust's earnings.” Therefore, it allowed the mutual fund trusts not to record income taxes (assuming the conditions in that EIC were met).

The conditions expressed in EIC 107 were to determine whether a mutual fund should be within the scope of CICA 3465 (i.e. whether or not the entity was “in substance” taxable). Similar conditions apply under IFRS in assessing whether mutual fund trusts have an “in substance” exemption from taxation and are thus not in the scope of IAS 12. As a result, Canadian mutual fund trusts are generally outside of the scope of IAS 12 and do not record income taxes in respect of Canadian income under IFRS. These funds may still face withholding and other taxes in foreign jurisdictions and are required to assess whether income taxes, including any resulting deferred taxes payable to that foreign jurisdiction, should be recognized as a result. For example, this may be the case if a fund holds an investment in a jurisdiction with capital gains taxes for which no tax treaty exists or tax treaty benefits do not apply. In such cases, an accrual for capital gains taxes payable to the foreign jurisdiction on unrealized gains may be required, consistent with the requirements under Canadian GAAP.

Mutual fund corporations (MFCs) also act as flow through vehicles on certain types of income (i.e. dividends from Canadian corporations and capital gains), which result in this type of income being taxed in the hands of the funds’ investors. Specifically, the corporation does not incur any income tax expense on dividends received from taxable Canadian corporations or on capital gains realized to the extent that these sources of income are paid to shareholders in the specified form of taxable Canadian dividends or capital gains dividends, respectively, subject to any applicable capital gains taxes refundable through redemptions. Similar to mutual fund trusts, the articles of incorporation will often require that the corporation distribute these types of income to shareholders in order to avoid them being taxed within the corporation. As a result, MFCs might also be viewed as being “in substance” tax exempt on these specific types of income, despite that the corporations are taxable overall and are required to record income taxes. All income other than capital gains and Canadian dividends are taxable (i.e. requiring that income taxes be recorded as a result) and commonly include foreign income, interest income and income from derivatives.

Other issues related to income taxes for investment funds which require consideration include loss carry-forward balances and uncertain tax positions. In particular, loss carry-forward balances will need to be evaluated to determine whether or not they should be recorded as deferred tax assets, particularly in mutual fund corporations that might otherwise pay income taxes, which may be the case in some circumstances. The basic recognition and measurement principles for deferred income taxes within IFRS are quite similar to previous Canadian GAAP.

Also, a fund’s tax position might be uncertain; for example, where the tax treatment of an item or transaction may be challenged by tax authorities in Canada or in foreign jurisdictions. Uncertainties in income taxes are not addressed specifically in IAS 12, however, the general measurement principles in IAS 12 should be applied such that current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities using the tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. [IAS 12 para 46]. When assessing uncertain tax positions individually, it should first be considered whether each position taken in the tax return is probable of being sustained on examination by the taxing authority and a liability should be recognized for each item that is not probable of being sustained. The liability is measured using either an expected value (weighted average probability) approach or a single best estimate of the most likely outcome. The 'cumulative probability' model applied under US GAAP is not permitted under IFRS. A common area of income tax uncertainty is with respect to taxes that may be due to foreign authorities on non-Canadian portfolio holdings where those taxes are not withheld at source.

Accounting for income taxes can be a complex area for some funds, and in particular for those funds structured as corporations. Complex fund structures and investments in more complex instruments will generally necessitate a more rigorous ongoing assessment of the accounting for income taxes, and it may be prudent for preparers to discuss the accounting for income taxes early with their accounting advisors or auditor.

The recognition and presentation of transaction costs associated with the issuance of units will depend on whether these units are considered to be liabilities or equity for accounting purposes. It would be expected that transaction costs associated with the issuance of units that are considered liabilities for financial reporting purposes would be expensed in the period incurred. Generally, when this is the case, entities would tend to follow Example 7 in IAS 32 and transaction costs associated with the issuance of units would be expensed in the statement of comprehensive income since they reduce net assets attributable to unitholders when incurred.

Reference to the revised version of NI 81-106 released on October 3, 2013 should be made to determine if additional financial statement line items or disclosures are required by the Canadian Securities Administrators.

Reference to the Canadian Securities Administrators Staff Notice 52-306 *Non-GAAP Financial Measures and Additional GAAP Measures* should also be made if additional sub-totals are added to the statement of comprehensive income in accordance with IAS 1.85 which permits the inclusion of additional line items, headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance.

Statement of Cash Flows

IAS 7 *Statement of Cash Flows* sets out the requirements for presenting such statements. Investment entities will now be required to present this statement as there is no exemption. The statement may be presented using the "direct method" or the "indirect method" and IAS 7 provides examples of both formats.

Within the statement, cash flows are presented in three different categories: cash flows from operating activities, cash flows from investing activities and cash flows from financing activities. IAS 7 provides guidance on allocating cash flows into these categories and sets out parameters around the presentation of cash flows on a net basis. Some accounting policy choices will need to be made, particularly with respect to dividends and interest received/paid.

Statement of Changes in Equity

The presentation of the statement of changes in equity is discussed in IAS 1. This statement will be required unless the entity has no equity to report, for example because all of its beneficial unitholders' interests are reported as liabilities. However, IAS 1 also suggests that entities which do not have equity may need to adapt the financial statement presentation of members' or unitholders' interests, which could include presenting a statement of changes in net assets attributable to unitholders' (see in particular IAS 1.6). Also NI 81-106 requires a statement of changes in net assets even if all units are presented as liabilities.

If this statement is presented, certain information must be presented by component of equity as set out in IAS 1.106. Components of equity include, for example, capital contributed by equity interest holders, retained earnings and the various classes of accumulated other comprehensive income, as appropriate. Investment entities will need to develop procedures for tracking this information if the statement is required.

Schedule of Investments

The investment entities covered by this paper will also be subject to regulatory requirements to provide a schedule of investments. It should be noted that this schedule should not be portrayed as part of the primary statements under IFRS and the information presented in the schedule is not required under IFRS. As such, this schedule is usually presented on a non-comparative basis and forms part of the notes to the financial statements. This schedule may be presented after the primary financial statements and before the rest of the financial statement notes.

Notes to Financial Statements

IFRS 7 – *Financial Instruments: Disclosures* was amended in 2013 to require entities to identify and disclose not only the financial assets and liabilities that have been offset in the statement of financial position but also those recognized assets and liabilities that would be offset if future events, such as bankruptcy or the termination of the contracts, were to arise. Identifying these arrangements may require significant time and effort, and may require the participation of legal counsel. It should be noted that the requirements for disclosure under IFRS are broad in scope and include **all** financial assets and liabilities that are subject to master netting or other similar arrangements, which is more extensive than the US GAAP equivalent (ASU 2011-04).

Examples of master netting or similar agreements include but are not limited to: derivative clearing agreements, global master repurchase agreements, global master securities lending agreements and any related rights to financial collateral, prime broker and custodial agreements. Instruments include, but are not limited to: derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, securities lending, trade receivables and payables with the same counterparty, interest payments and collateral provisions under a credit facility. Examples of financial instruments that are not within the scope of this standard are loans and customer deposits at the same institution (unless they are set off in the statement of financial position) and financial instruments that can be offset only with non-financial collateral.

In implementing this standard, entities will need to perform an analysis of which transactions and financial instruments are ‘in-scope’. The determination of which agreements qualify as master netting agreements or whether the provisions within those agreements are an enforceable right to offset may be time consuming, difficult and may require the involvement of legal counsel. Entities will need to establish a process for vetting these agreements to determine if they qualify for the disclosures within the notes to the financial statements and capturing the data required to be disclosed as of the date of transition to IFRS and on an ongoing basis.

For those financial instruments and agreements determined to be in scope, within the notes to the financial statements, entities are required to disclose the following five elements: (a) the gross amounts of financial assets and financial liabilities, (b) the amounts that are set off in accordance with criteria in paragraph 42 of IAS 32, (c) the net amounts presented in the statement of financial position, (d) the amounts subject to an enforceable master netting arrangement or similar agreement (i.e. amounts that do not meet all the offsetting criteria in paragraph 42 of IAS 32, and amounts related to financial collateral), and (e) the net amount of the above after all set-off rights were exercised.

Entities may present the disclosures in (c) to (e) by type of financial instrument or transaction, or may choose to further disaggregate the information by counterparty (without specifically naming the counterparty, although utilizing a consistent identifier year to year). In all cases, the disclosed amounts will need to reconcile to amounts presented in the statement of financial position.

The quantitative disclosures required by (c) to (e) above are considered minimum requirements, and in order to meet the objective of the standard, entities may need to supplement them with additional qualitative disclosures depending on the nature of the arrangements and their impact on the entity’s financial position.

Interim Financial Statements

The first statement that most entities will provide under IFRS will be an interim statement. The requirements for these statements are set out in IAS 34 *Interim Financial Reporting*. Interim statements prepared under IAS 34 should generally be referred to as “condensed” since they do not include all the disclosures required under IFRS. The guidance provided by the regulators (Top 10 tips for first IFRS interim financial statements) can be found in the attached guide. We draw your attention to item 6 which provides some guidance on what should be included in interim financial statements.

Although IAS 34 states that it is not mandatory to follow this standard for interim statements, NI 81-106 requires reporting issuers to apply IAS 34 and therefore an explicit statement of compliance with IAS 34 must be included in interim statements.

However, in the year of adoption of IFRS, it will be necessary to include more disclosures than would be required in interim statements after the year of adoption. Disclosure in interims in the year of adoption is discussed in IFRS 1.33. The presentation of an opening statement of financial position for the comparative period is also required in interim financial statements. For example, a calendar year end investment fund will be required to provide at June 30 statements of financial position as at June 30, 2014, December 31, 2013 and January 1, 2013. For greater clarity, NI 52-107 also clarifies that the opening statement of financial position as of the beginning of the comparative year in the year of adoption is required to be included in the first interim financial statements as well as in the annual financial statements in the year of adoption.

IAS 34 includes a number of specific items that need to be disclosed in condensed interim financial statements. Because of the importance of fair value measurement, it is worth noting that among these specific disclosures are some items related to fair value. IAS 34.16A(j) provides references to the disclosures in IFRS 7 and 13 that are explicitly required to also be provided in condensed interim financial statements.

Disclosure

Almost every IFRS standard has specific disclosure requirements that need to be considered, depending on the nature of an investment fund's operations and investments. Standards whose disclosure requirements might be more important for investment funds are listed below. This list is by no means exhaustive.

Standard	**Comments**
IAS 1, *Presentation of Financial Statements*	This standard sets out specific items that need to be disclosed if they are not presented separately on the face of the applicable statement; it also includes disclosure requirements associated with more general matters, such as significant accounting policies, sources of estimation uncertainty and significant judgments
IAS 7, *Statement of Cash Flows*	This standard sets out disclosure requirements related to items presented in the statement of cash flows
IAS 8, *Accounting Policies, Changes in Estimates and Errors*	This standard provides guidance on the disclosure of accounting policies and the different types of accounting changes and disclosures that must be provided when there has been a change
IAS 10, *Events After the Reporting Period*	This standard sets out the disclosure requirements associated with events that occur after the date of the statement of financial position but before the financial statements are issued, including disclosure related to distributions declared after the end of the reporting period
IAS 18, *Revenue*	This standard sets out disclosure requirements for revenue by significant category, such as dividends and interest
IAS 21, *The Effects of Changes in Foreign Exchange Rates*	This standard sets out disclosure requirements related to the entity's functional currency and transactions and balances in currencies different than the functional currency
IAS 24, *Related Party Disclosures*	This standard provides guidance on identifying parties related to the reporting entity and sets out disclosure requirements for these relationships and transactions with related parties
IAS 33, *Earnings Per Share*	This standard sets out the disclosure requirements to be followed when earnings per share or per unit are required to be presented and also provides disclosure requirements to be followed when alternative measures of earnings per share or unit are presented; the applicability of this standard may vary depending on whether an investment entity reports any of its unitholders' interests as equity
IAS 34, *Interim Financial Statements*	This standard provides guidance on the information that should be disclosed in interim financial statements, including some disclosures from IFRS 7 and 13 that must be provided in interim statements related to financial instruments (see IAS 34.16A(j))
IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*	This standard provides the disclosure requirements associated with liabilities and possible liabilities of uncertain timing and amount
IFRS 1, *First Time Adoption of IFRS*	This standard sets out the disclosures to be provided by first time adopters of IFRS

Standard	Comments
IFRS 7, *Financial Instruments: Disclosures*	This standard sets out the disclosures to be provided related to financial instruments held as investments, as well as unit or shares issued to investors; in addition, disclosure requirements related offsetting, or netting, of financial instruments are also provided
IFRS 8, *Operating Segments*	This standard sets out the information to be disclosed related to operating segments; investment entities are not exempted from this standard as long as they file their financial statements with securities regulators for the purpose of issuing any class of instruments in public markets
IFRS 12, *Disclosure of Interests in Other Entities*	This standard sets out disclosure requirements related to interests in other entities, including some disclosure requirements specifically for investment entities that have subsidiaries
IFRS 13, *Fair Value Measurement*	This standard sets out disclosure requirements related to items, such as financial instruments, recorded or disclosed at fair value.

APPENDIX A Disclosure of Interest Income for Distribution

Notes to the financial statements

Statements of Comprehensive Income

For the periods ended December 31

In thousands (except per security figures)

	2014	2013
	$	$
Income		
Net Gains on investments (Note XX)		
Dividends	27,346	25,728
Interest for distribution purposes	40,034	29,161
Realized gain (loss) on sale of investments	25,717	10,428
Change in unrealized appreciation (depreciation)	48,235	(7,699)
Net Gains on investments*	141,332	57,618
Other income items such as FEX gains:		
Comprised of (see note 1 in comments for users below):		
Financial assets designated at FVPTL:	xx,xxx	xx,xxx
Financial assets classified as held for trading	xx,xxx	xx,xxx
Total	141,332	57,618

The interest for distribution purposes shown on the statements of comprehensive income represents the coupon interest received by the fund accounted for on an accrual basis. The fund does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds which are amortized on a straight line basis.

Realized gain/loss on sale of investments and unrealized appreciation/depreciation in investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds.

Comments for users

1. The breakdown of net gains on investments between FVTPL and HFT which is required by IFRS 7.20 (a) (i) can be disclosed either in the statement of comprehensive income or in the fund specific notes or in the combined notes to the financial statements.
2. Transaction costs will be shown as expenses and not netted against income.

APPENDIX B Guidance of IFRS Classification and Measurement of Financial Instruments

Relevant IFRS: IFRS 9 (as issued by the IASB on July 24, 2014)

Overview

IFRS 9 as issued by the IASB in July 2014 (IFRS 9) is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. Entities adopting IFRS 9 for the first time after February 1, 2015 are required to adopt this latest version of the standard.

Many aspects of IFRS 9, including its scope and requirements for initial measurement and the recognition and de-recognition of financial instruments are largely unchanged from IAS 39. The notable changes included in IFRS 9 are summarized as follows:

- Provides a principle-based classification of financial instruments that focuses on the entity's business model and the nature of the cash flows associated with the financial instruments.
- Reduces the number of classifications for financial assets from six to three (held to maturity, loans and receivables and available-for-sale classifications in IAS 39 are eliminated).
- Provides a single impairment method that is based on the expected credit loss (ECL) model and applies to all financial assets not measured at fair value through profit or loss (FVTPL). A simplified assessment is available for trade receivables and lease receivables meeting certain criteria.
- Improves hedge accounting by aligning the accounting treatment with risk management practices (although likely not relevant to the investment funds industry).

For investment funds, the most notable improvement is the introduction of the business model approach to the classification process. The assessment of the business model is determined at an aggregated or portfolio level (not an instrument-by instrument assessment), and can result in measuring assets at FVTPL without having to 'designate assets at FVTPL' and meet the additional note disclosures associated with that category.

Classification of Financial Assets

Under IFRS 9, financial assets are classified to one of the following three categories:

1. Amortized cost – assets held within a business model whose objective is to collect cash flows and where the contractual cash flows of the assets are solely payments of principal and interest (SPPI criterion).
2. Fair value through other comprehensive income (FVOCI) – Financial assets such as debt instruments that meet the SPPI criterion and are held within a business model with objectives that include both collecting the associated contractual cash flows and selling financial assets.
3. Fair value through profit or loss (FVTPL) –A financial asset is measured at FVTPL unless it is measured at Amortized Cost or FVOCI. Derivatives are measured at FVTPL.

It should be noted that investments in equity instruments are classified as FVTPL unless designated irrevocably at initial recognition as FVOCI. However, it would seem unlikely that investment funds would utilize this designation through OCI.

In addition, IFRS 9 permits an entity to irrevocably designate a financial asset at FVTPL at initial recognition if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Classification – Assessment of the Business Model

According to Appendix C to IFRS 9, the entity's business model refers to how an entity manages its financial assets in generating cash flows. It is not defined by management's intentions for any individual instrument (i.e. not an instrument-by-instrument approach to classification) but is determined at a higher level of aggregation that reflects how groups of assets are managed together to achieve a particular business objective.

The appendix provides guidance for determining whether a business model aims to manage the financial assets to solely collect the contractual cash flows; to both collect the contractual cash flows and sell the assets; or whether the assets are managed under 'other business models'. Financial assets managed under 'other business models' are measured at FVTPL and are not subject to the assessment of contractual cash flows at the individual instrument level.

The objectives and activities applied in managing financial assets within investment funds would likely fall into this last category of 'other business models', resulting in measurement at FVTPL, as described in Appendix C (Chapter 4) to IFRS 9:

'Financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. One business model that results in measurement at fair value through profit or loss is one in which an entity manages the financial assets with the objective of realising cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realise those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a business model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the business model's objective; instead, it is incidental to it.

A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 4.2.2 [see classification of financial liabilities above]*) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the business model's objective. Consequently, such portfolios of financial assets must be measured at fair value through profit or loss."*

Classification of Financial Liabilities

The classification of financial liabilities under IFRS 9 is largely unchanged from that used in IAS 39. Under IFRS 9, financial liabilities are measured at amortized cost except for the following items:

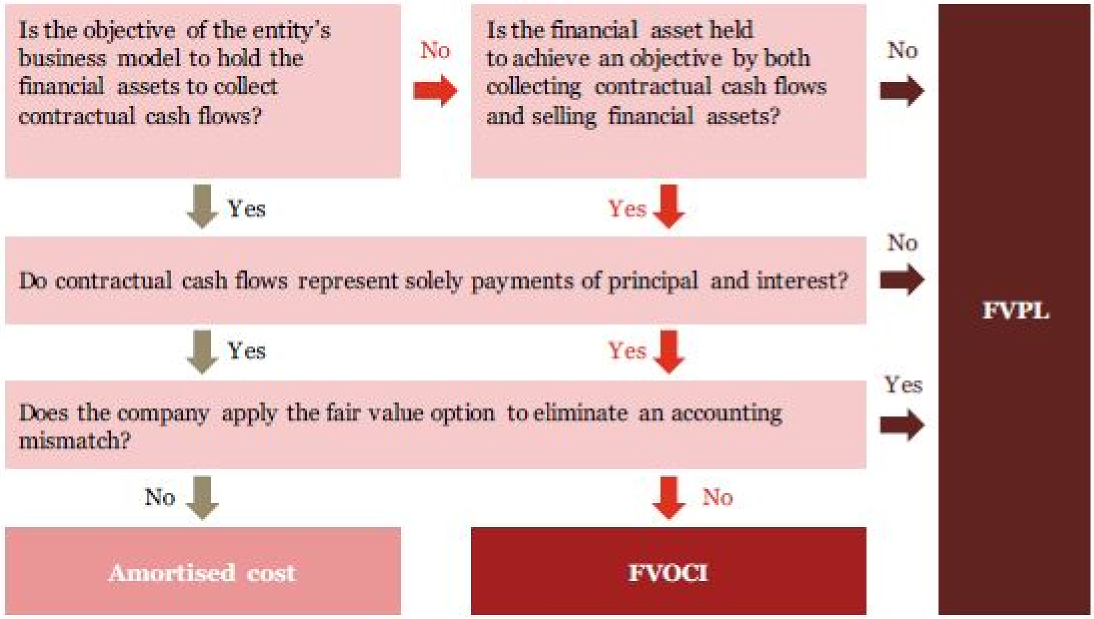
- Financial liabilities at FVTPL such as derivatives;
- Financial liabilities arising from the transfer of a financial asset that did not qualify for de-recognition;
- Financial guarantee contracts;
- Commitments to provide a loan at below-market interest rates.

In addition, the standard permits an entity to designate a group of financial liabilities or group of financial assets and financial liabilities at FVPTL when doing so results in more relevant information because it eliminates or reduces an accounting mismatch or because a group of financial assets and liabilities is managed together and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to key management personnel (Paragraph 4.2.2).

Classification

Classification of financial assets under IFRS 9 involves making an assessment of the cash flows associated with the financial assets along with an assessment of the business model applied in managing financial assets. The standard doesn't specify the ordering of these assessments however, in the basis for conclusion (BC4.14), the IASB supported comments that it is more efficient for entities to consider the business model first.

The classification of financial assets is illustrated in the following diagram (source: PwC):



Application by Investment Funds

In applying IFRS 9, investment funds will need to carefully assess their individual business models to determine whether the financial instruments managed within the fund are considered to be 'a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis in accordance with an investment strategy, and is reported internally to key management on that basis', in order to conclude that the investments are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets, and are therefore measured at FVTPL and not subject to assessments of cash flows at the individual instrument level. Some fund structures and related business models may be more complex to assess.

Evidence of the Business Model

Appendix B also explains that the business model is considered to be a matter of fact; not merely an assertion or management's intention; it is typically observable through particular activities that the entity undertakes in achieving its business objectives and in how information is provided to key management in evaluating performance of the assets.

Objective information to be considered can include the entity's business plans, how the financial instruments are managed and evaluated against those business plans, how the performance of the instruments is aggregated and reported to key management, how managers are compensated, and the frequency of sales activity occurring. Judgement is required in assessing all relevant aspects and all information available to determine the business model and the most appropriate classification and measurement of the financial instruments at the date of assessment.

Conclusion

Classification and measurement under IFRS 9 requires careful assessments of business models and objectives applied in managing financial assets. The more principles-based approach to classification provided by IFRS 9 offers a pragmatic classification at an aggregated or portfolio level that is more representative of how the financial assets are managed and evaluated by management in achieving the investment fund's investment objects. The business-model approach to classifying and measuring financial assets also results in more relevant information and measurement of investments reported to investors.

However, it should be noted that the standard is new, practice is evolving both in Canada and globally and views and interpretations may still evolve. Further, there have been multiple iterations of the standard which have several differences. Users should ensure that they consider the implications of the latest standard even though based on their year end, they may be adopting an earlier version.

APPENDIX C Additional Discussion on Business Models

(extracts from IFRS 9)

A business model whose objective is to hold assets in order to collect contractual cash flows

B4.1.2C Financial assets that are held within a business model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However, sales in themselves do not determine the business model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are realised. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions.

B4.1.3 Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future.

B4.1.3A The business model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a business model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimising potential credit losses due to credit deterioration are integral to such a business model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk.

B4.1.3B Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's business model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows.

A business model whose objective is achieved by both collecting contractual cash flows and selling financial assets

B4.1.4A An entity may hold financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of business model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the business model. There are various objectives that may be consistent with this type of business model. For example, the objective of the business model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such an objective, the entity will both collect contractual cash flows and sell financial assets.

B4.1.4B Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the business model's objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this business model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective

Examples of business model objectives that could be consistent with the FVOCI business model:
- Managing everyday liquidity needs;
- Maintaining a particular interest yield profile; and
- Matching the duration of the financial assets to the duration of the liabilities that those assets are funding.