ASSURANCE AND ACCOUNTING

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE) UPDATE 2018

Introduction

It was a busy year for the Accounting Standards Board (AcSB) and for Part II of the CPA Canada Handbook – Accounting: Accounting Standards for Private Enterprises (ASPE). The Board was hard at work advancing the progress of various projects, including its projects on retractable or mandatorily redeemable shares issued in a tax planning arrangement, related party financial instruments and agriculture. In addition, significant amendments made to Section 1591, *Subsidiaries*, and Section 3051, *Investments*, as well as the 2017 annual improvements became effective this year. This publication will discuss these and other projects the AcSB is currently working on.

Standards Effective in 2018

Subsidiaries & Investments

During 2016, the Board approved amendments to Section 1591, *Subsidiaries*, and Section 3051, *Investments*, that clarify the accounting for a subsidiary and an investment subject to significant influence when the cost method is used. Section 1591 provides an accounting policy option for a private enterprise to either consolidate its subsidiaries or account for its subsidiaries using the equity method or the cost method. The underlying principle of the amendments is that the initial measurement of an interest in a subsidiary that is subsequently accounted for using the cost method should be on a basis similar to other business combinations. Other key features of the amendments are as follows:

Cost Method – Initial Measurement

- A subsidiary transferred between enterprises under common control is initially accounted for at cost when the following conditions are met:
  - The transaction is a monetary or non-monetary transaction that has commercial substance (see paragraph .19 of Section 3840, *Related Party Transactions*);
  - The change in the ownership interests in the item transferred is substantive; and
  - The amount of consideration paid or received as established and agreed to by the related parties is supported by independent evidence.

  If these three conditions are not met, the acquiring enterprise initially measures its interest in the subsidiary at the carrying amount as defined in paragraph 3840.03(a).
- The cost of an interest in a subsidiary and of an investment subject to significant influence is measured at the acquisition-date fair value of the consideration transferred (including contingent consideration) to the other party in exchange for the interest.
- Acquisition-related costs are expensed, except for costs to issue debt and equity securities.
- Initial measurement of an interest in a subsidiary measured at cost is consistent with Section 1582, *Business Combinations*, except that bargain purchase gains are not recognized and acquisitions of additional interests are measured at cost.
- When an enterprise obtains control over another enterprise in stages, the cost of the interest in the subsidiary is:
  - The carrying amount of the enterprise's interest in the other enterprise immediately before the date control was acquired; plus
  - The cost of the additional interest acquired.

  The enterprise must assess the carrying amount of the interest in the subsidiary for impairment. A very similar process is followed when an investor obtains the ability to exercise significant influence, but does not obtain control, over an investee in which the investor previously held an interest.

Cost Method – Subsequent Measurement

- Earnings from an interest in a subsidiary and an investment subject to significant influence are recognized in income only when received or receivable.
- Contingent consideration is remeasured when the contingency is resolved on the same basis required by Section 1582.
- The provisional carrying amount of an interest in a subsidiary is adjusted in a subsequent period when the provisional amounts are finalized, which would not exceed one year from the acquisition date. The provisional amounts recognized on initial measurement in the prior period are not retrospectively adjusted.
- The requirements in Section 3051 on impairment would be applied to each subsidiary at the end of each reporting period.
- Additional guidance was also added to Section 1591 on how to account for subsequent changes in ownership interest of a subsidiary.

Equity Method

When an entity accounts for a subsidiary using the equity method, it applies that method in accordance with Section 3051. However, amendments were made to Section 1591 to clarify that in this situation the following accounting must also be applied:

- At the date of acquisition, contingent consideration for the acquisition of a subsidiary must be measured at fair value and included in the carrying amount of the investment. Subsequently, it must be measured on the same basis required by paragraph .60 of Section 1582.
- All acquisition-related costs must be expensed, except for costs to issue debt and equity securities.

Transition

These amendments to Sections 1591 and 3051, as well as consequential amendments to other Sections, are to be applied prospectively to new acquisitions of subsidiaries and investments subject to significant influence from the date the amendments become effective, which is fiscal years beginning on or after January 1, 2018, with earlier application permitted.

2017 Annual Improvements Process

As a result of the 2017 Annual Improvements Process to ASPE, amendments were made to the following Sections of the Handbook and are effective for years beginning on or after January 1, 2018, with earlier application permitted.

Disclosure of Accounting Policies

Paragraph .08 in Section 1505, *Disclosure of Accounting Policies*, requires that an entity's accounting policies be disclosed "as the first note" to the financial statements. However, some stakeholders noted that this requirement is too prescriptive. As a result, the Board has amended this paragraph to require that this disclosure be provided "in one of the first notes," rather than as the first note, to the financial statements.

Accounting Changes

Paragraphs .34-.35 of Section 1506, *Accounting Changes*, set out the disclosure requirements related to changes in accounting policy. Paragraphs 1506.34(e) and .35(c) required an entity to disclose the amount of an adjustment related to an accounting policy change "for the current period," but not for each of the prior period(s) presented. However, stakeholders noted that disclosing the adjustment related to the prior period(s), instead of the current period, is what actually meets user needs. As a result, the Board removed the requirement to disclose the amount of an adjustment related to an accounting policy change for the current period and disclosure "for each of the prior period(s) presented" is required instead.

Balance Sheet

Section 1521, *Balance Sheet*, distinguishes between the items that must be presented separately on the face of the balance sheet and those items that can either be presented separately on the balance sheet or in the notes. Some stakeholders have noted that Section 1521 was not consistent with the presentation and disclosure requirements set out in other standards in ASPE. As a result, the Board revised paragraphs 1521.04 and .05 to clarify the line items that are required to be separately presented on the balance sheet, and added paragraphs 1520.04A and .05A to clarify the line items that may either be presented separately on the balance sheet or in the notes to the financial statements.

Foreign Currency Translation

Paragraph .53 of Section 1651, *Foreign Currency Translation*, does not allow an entity to reverse previously recorded write-downs of inventory in the translated financial statements of an integrated foreign operation. However, this contradicts Section 3031, *Inventories*, which requires that previous write-downs of inventory be reversed when the circumstances that caused the write-down no longer exist or there is clear evidence of an increase in the net realizable value reflecting changes in economic circumstances. Consequently, the Board removed paragraph 1651.53 and provided further clarification of this situation in the example included in paragraph 1651.51.

Leases

Paragraph .81 in Section 3065, Leases, requires disclosure of the carrying amount of impaired operating lease receivables and the amount of any related allowance for impairment. However, Section 3856, *Financial Instruments*, was amended during the 2014 Annual Improvements to ASPE to only require disclosure of any allowance for impairment for current trade receivables and not the carrying amount of impaired current trade receivables. Stakeholders believe the impairment disclosure for operating lease receivables should be similar. Therefore, the Board amended paragraph 3065.81 to clarify that disclosure is only required for the amount of the allowance for impairment.

Projects on the Go

Exposure Draft — Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement

The AcSB believes that the accounting for retractable or mandatorily redeemable shares issued in a tax planning arrangement, as currently set out in paragraph .23 of Section 3856, *Financial Instruments*, needs to be re-examined, as a number of issues have arisen in respect of retractable or mandatorily redeemable shares. Currently, paragraph 3856.23 allows retractable or mandatorily redeemable shares issued in a tax planning arrangement under specific sections of the *Income Tax Act* to be presented at par, stated or assigned value as a separate line item in equity. The AcSB issued an Exposure Draft in October 2014 proposing the withdrawal of this paragraph and received a significant amount of feedback from stakeholders. The Board considered this feedback and issued a second Exposure Draft in September 2017 that proposed the following:

- The classification exception in paragraph 3856.23 would be amended to focus on whether control of the enterprise issuing the shares is retained.
- Guidance on assessing the effect of substantive rights in the control assessment would be added to Section 1591, *Subsidiaries*.
- For retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as equity, the amendments would require a reassessment of the classification only when a subsequent event or transaction occurs that indicates one or more of the conditions for equity classification may no longer be met. When the conditions for equity classification are no longer met at the reassessment date, the shares would be required to be reclassified as financial liabilities.
- Retractable or mandatorily redeemable shares issued in a tax planning arrangement initially classified as financial liabilities would be prohibited from being subsequently reclassified to equity even if conditions change.
- Retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as financial liabilities would be measured at the redemption amount.
- Guidance would be added to Section 3251, *Equity*, to require that the effect of classifying and measuring the retractable or mandatorily redeemable shares as financial liabilities be presented as a separate component of equity and to require disclosure of the nature of this separate component of equity.

The proposed effective date for the amendments is fiscal years beginning on or after January 1, 2020. Retrospective application would be required.

The Board has deliberated the feedback received on the second Exposure Draft and as a result has decided to make the following changes to the proposals:

- Clarify the conditions for the classification exception;
- Provide an option to classify the shares as a financial liability even if all the conditions for the classification exemption could be met;
- Provide an option to present the effect of liability classification of the shares in either retained earnings or a separate component of equity;
- Provide additional guidance on determining the related party unit of account;
- Provide guidance on assessing whether a tax planning arrangement undertaken in a series of steps should be viewed as one tax planning arrangement;
- Clarify whether the decision tree in paragraph 3856.A29 also applies to retractable or mandatorily redeemable shares issued in a tax planning arrangement; and
- Provide additional transitional relief to assist stakeholders with adoption of the amendments.

The Board plans to issue the final amendments to the Handbook no later than the fourth quarter of 2018. As this project will have an impact on many private enterprises, we encourage you to stay up to date on the latest details by checking out the project page on the Financial Reporting & Assurance Standards website, which can be accessed here.

Exposure Draft — Agriculture

When ASPE was being developed, stakeholders noted that one important topic not addressed in Canadian Generally Accepted Accounting Principles was accounting for agricultural activity. Agriculture is a significant industry in Canada and due to the lack of accounting standards addressing the unique aspects of agriculture, there is diversity in accounting practices particularly around the measurement of biological assets and agricultural inventories. The AcSB issued an Agriculture Discussion Paper in December 2015 to obtain input from stakeholders to assist in determining whether the Board should develop authoritative guidance on this topic.

In early 2017, the Board formed an Agriculture Advisory Group, which consists of a number of individuals with a range of background experiences including farmers, preparers, practitioners, users, government employees, and academics to act in an advisory capacity to the Board. Based on the feedback received from stakeholders on the Discussion Paper, through additional consultations and field testing, as well as from the Advisory Group, the Board developed and issued an Exposure Draft in July 2018. The main features of the Exposure Draft on proposed Section 3041 are as follows:

Scope

- The Section would apply to an agricultural producer's agricultural inventories and productive biological assets, including harvested products of biological assets that have been purchased by an agricultural producer.
- It would not apply to assets resulting from activities that transform an item of agricultural inventory into a different asset (secondary production). Such assets would be within the scope of other Sections such as Section 3031, Inventories.

Recognition

- Biological assets not used in a productive capacity would be presumed to be agricultural inventories on initial recognition. An agricultural producer could choose to rebut this presumption on initial recognition when its intention is to develop the asset into a productive biological asset.

Measurement of agricultural inventories

- An agricultural producer would make an accounting policy choice to measure agricultural inventories using the cost model, or the net realizable value model when specified conditions are met.
- An agricultural producer that measures agricultural inventories using the cost model would make another accounting policy choice to determine cost using either full cost, or only the input costs directly attributable to the inventories.
- Agricultural inventories measured using the cost model would be written down to net realizable value when the cost of the inventories exceeds their net realizable value.
- For agricultural inventories measured using the net realizable value model, changes in net realizable value after initial recognition would be recognized in net income.

Measurement of productive biological assets

- Productive biological assets would be measured at cost less accumulated amortization and impairment, if any.
- Productive biological assets managed on a collective basis to maintain their collective productive capacity indefinitely would not be amortized, but would be subject to impairment.
- When a productive biological asset is no longer used in a productive capacity, it would be measured at the lower of its carrying amount and fair value less costs to sell until it is sold or disposed of other than by sale.
- Productive biological assets would not be reclassified to agricultural inventories.

Change in use

- When an agricultural producer starts using an item of agricultural inventory in a productive capacity, it would reclassify the item from agricultural inventories to productive biological assets. The carrying amount of the item of agricultural inventory would be the deemed cost of the productive biological asset on reclassification.

Disclosure

- An agricultural producer would be required to disclose the following for its agricultural inventories and productive biological assets:
    - A qualitative description of the assets, the quantities of assets held, and the measurement methodologies used.
    - The carrying amount of the assets and the related amounts recognized in profit or loss during the period.

The proposals would be applied retrospectively, with simplified transitional provisions, for fiscal years beginning on or after January 1, 2021. The Board is seeking feedback on the proposals and stakeholders are encouraged to respond to the Exposure Draft, which can be accessed here, by October 31, 2018. The Board is also holding various roundtables to give stakeholders additional opportunities to provide their views on the proposals. Sign up for a roundtable here. The Board will then review all the feedback received on the proposals and determine next steps.

Exposure Draft — Financial Instruments

In 2014, the AcSB issued its Post-implementation Review: Section 3856, *Financial Instruments*. Based on the feedback provided, the Board understood that the current guidance on the scope of accounting for related party financial instruments after initial recognition and the measurement of related party compound financial instruments is not clear and is resulting in diversity in practice. Additionally, financial instrument risk disclosures are not entity-specific and therefore are not providing useful information. As a result, the Board issued an Exposure Draft in October 2017. Some of the proposed main changes are as follows:

Scope

- The scope of Section 3856 would be amended to make it clear that the Section applies to the initial and subsequent measurement, derecognition, presentation, and disclosure of related party financial instruments.
- Guidance on how not-for-profit organizations initially measure related party financial instruments would be added.

Initial Measurement

- Section 3856 would explain that related party financial instruments would be initially measured at cost, unless the instrument is equity that is quoted in an active market or a derivative contract. Such instruments would be measured at fair value without any adjustment.
- The cost of a financial instrument in a related party transaction would depend on whether the instrument has repayment terms.
- The election to initially measure financial assets or financial liabilities at fair value would be prohibited for related party financial instruments.
- The equity component of a related party compound financial instrument would be permitted to be initially measured as zero.

Subsequent Measurement

- Section 3856 would explain that subsequently related party financial instruments would be measured at cost, less any reduction for impairment; except for equity instruments quoted in an active market and derivative contracts, which would be measured at fair value.

Presentation of Impairment and Forgiveness

- An enterprise would be required to first assess for, and recognize in net income, any impairment of a related party financial asset before the forgiveness of the related party financial asset is recognized.
- Except for not-for-profit organizations, the forgiveness of a related party financial asset would be recognized in:
  - Equity when the original transaction that resulted in acquiring the financial asset was not in the normal course of operations; or
  - Net income when the original transaction that resulted in acquiring the financial asset was in the normal course of operations or when it is impracticable to determine whether the amount forgiven originated outside the normal course of operations.
- For not-for-profit organizations, the Board sought stakeholder feedback on whether guidance on forgiveness of related party financial assets was needed.

Modifications and Extinguishment

- All modifications of a related party financial liability would be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.
- Not-for-profit organizations would recognize an extinguishment of a financial liability in accordance with Section 4410, *Contributions – Revenue Recognition*.

Disclosure

- Requirements would be added to Section 3856 for an enterprise to disclose when it recognizes the forgiveness of a related party financial asset or extinguishment of a related party financial liability in net income because it is impracticable to determine whether the amount forgiven or extinguished originated in the normal course of operations.
- The requirement to permit disclosures about significant risks arising from derivatives would be included with risks arising from other financial instruments, instead of disclosed separately.

The proposals would be applied retrospectively, with simplified transitional provisions, for fiscal years beginning on or after January 1, 2020.

Based on feedback received on the Exposure Draft, the Board is planning to amend some of the proposed changes to make the guidance clearer and to address several issues raised by respondents. The Board plans to issue the final amendments to the Handbook during the fourth quarter of 2018.

Narrow Scope Amendments — Income Taxes

Effective January 1, 2017, the eligible capital property (ECP) rules in Section 14 of the *Income Tax Act* were repealed and replaced by new Class 14.1 of Schedule II to the Income Tax Regulations. As a result, an example in paragraph .14(f) of Section 3465, *Income Taxes*, is now outdated since it provides guidance on accounting for ECP, which is no longer applicable.

Additionally, a recent amendment was made to US Generally Accepted Accounting Principles, which eliminates the requirement to segregate deferred tax assets and liabilities into current and non-current components. Section 3465 currently requires future income tax assets and liabilities to be presented as current or non-current when an entity follows the future income taxes method.

Due to the above, the Board has decided the outdated example in 3465.14(f) should be removed and that entities applying the future income taxes method should present future income tax assets and liabilities as non-current and disclose the amount instead. The Board issued an Exposure Draft in September 2018 on these proposed changes, which can be accessed here. Stakeholders are encouraged to provide their feedback by December 5, 2018.

Narrow Scope Amendments — Investments

In December 2016, paragraph .07A was added to Section 3051, *Investments*, to provide guidance on how to apply the cost method when determining the initial measurement of an investment subject to significant influence. Section 3056, *Interest in Joint Arrangements*, permits the use of either the equity method or the cost method, as set out in Section 3051, when accounting for an interest in a jointly controlled enterprise. Stakeholders have questioned whether paragraph 3051.07A also applies to an interest in a jointly controlled enterprise accounted for using the cost method. The Board issued an Exposure Draft in September 2018 to clarify paragraph 3051.07A does apply to interests in jointly controlled enterprises accounted for using the cost method. The Exposure Draft can be accessed here and stakeholders are encouraged to provide feedback by December 5, 2018.

Narrow Scope Amendments — Revenue

In 2017, the AcSB issued a survey asking stakeholders for feedback on issues they encountered when applying the current guidance in Section 3400, *Revenue*. Based on the feedback provided, the Board understands that a lack of guidance in certain areas is causing issues when applying the standard. As a result, the Board has taken on a narrow scope amendment project on Section 3400 and plans to propose additional guidance on the following topics:

- Bill-and-hold arrangements;
- Multiple-element arrangements;
- Percentage of completion method;
- Reporting revenue gross or net; and
- Upfront non-refundable fees/payments.

The Board also plans to continue examining the need for future improvements including an assessment of whether the current risk-and-rewards model is still appropriate.

Conclusion

As we head closer to the end of the year, now is the time to check in with your BDO advisor about how the changes made and the ASPE projects on the go will affect your organization.

The information in this publication is current as of September 17, 2018.

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