ASSURANCE AND ACCOUNTING

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE) UPDATE 2019

Introduction

It was a busy year for the Accounting Standards Board (AcSB or the Board) 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 agriculture and revenue. In addition, the Board approved two new projects, one on employee future benefits and another on financial statement concepts. While no new standards became effective in 2019, several significant amendments related to financial instruments will become effective in 2020. This publication will discuss these changes, as well as, other projects the AcSB is currently working on.

Standards Effective in 2020

Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement

The AcSB believed that the accounting for retractable or mandatorily redeemable shares issued in a tax planning arrangement (RoMRS), as previously set out in paragraph .23 of Section 3856, *Financial Instruments*, needed to be re-examined, as a number of issues had arisen in respect of such shares. Previously, paragraph 3856.23 allowed preferred shares issued in a tax planning arrangement under specific sections of the *Income Tax Act* to be presented at their par, stated or assigned value as a separate line item in equity. After receiving feedback from stakeholders through two Exposure Drafts, in December 2018, the Board issued amendments to Section 3856 on how RoMRS should be accounted for under ASPE. Some key features of the amendments include:

- When an entity issues RoMRS, it may choose to present those shares at par, stated or assigned value as a separate line item in the equity section of the balance sheet only when all of following conditions are met:
  - Control of the entity (as outlined in Section 1591, *Subsidiaries*) issuing the RoMRS is retained by the individual shareholder receiving the RoMRS in the arrangement;
  - In the tax planning arrangement, either no consideration is received by the entity issuing the RoMRS or only shares of the entity issuing the RoMRS are exchanged; and
  - No other written or oral arrangements (such as a redemption schedule) exist, that gives the holder of the RoMRS the contractual right to require the entity issuing the RoMRS to redeem the shares on a fixed or determinable date or within a fixed or determinable period.

  However, if any of the above conditions are not met for any or all of the shares issued, the entity must classify the shares as a financial liability and present them as a separate line item on the balance sheet at their redemption amount.
- When RoMRS are issued to two or more related parties, an assessment of which related party, if any, controls the entity is needed to determine whether the control condition outlined above is met.
- An entity also has the choice to classify RoMRS as a financial liability initially, even if the criteria for equity classification outlined above are met. However, once RoMRS have been classified as a financial liability they can never subsequently be reclassified as equity.
- RoMRS initially classified as equity, are not subsequently reclassified as a financial liability unless an event or transaction occurs that indicates that the conditions for equity classification are no longer met.
- Upon reclassification to a financial liability, the ROMRS must be measured at their redemption amount with any resulting adjustment recorded in retained earnings or as a separate component of equity.
- Additional disclosures including a description of the tax planning arrangement that gave rise to the shares and their redemption amount are also required.

The effective date of the amendments is fiscal years beginning on or after January 1, 2020, with earlier adoption permitted. As a result, of these amendments, more entities will need to classify RoMRS as liabilities than in the past. To help ease an entity's adoption of these amendments, several transitional provisions have been included in Section 3856, including:

- The ability to apply the amendments at the beginning of the fiscal year the amendments are first applied, without restatement of prior years; and
- Less stringent criteria for assessing control and consideration transferred for RoMRS issued prior to January 1, 2018.

As a result of the amendments discussed above for RoMRs, guidance on assessing the effect of substantive rights when determining control has be added to Section 1591, *Subsidiaries*. As well, guidance has been added to Section 3251, *Equity*, on recording the adjustments for RoMRS in either retained earnings or a separate component of equity and additional disclosure requirements have been added.

Related Party Financial Instruments

In 2014, the AcSB issued its Post-implementation Review: Section 3856, *Financial Instruments*. Based on the feedback received from stakeholders, the Board understood that the current guidance on accounting for related party financial instruments after initial recognition and the measurement of related party compound financial instruments was not clear and was resulting in diversity in practice. Additionally, financial instrument risk disclosures were not entity-specific and therefore were not providing useful information to financial statement readers. As a result, the Board issued an Exposure Draft in October 2017 proposing changing to Section 3856, and Section 3840, *Related Party Transactions,* to clarify these issues. Based on feedback received, the Board issued amendments to these two Sections in December 2018. Some of the main changes are as follows:

Scope

- All the guidance on related party financial instruments has been moved into Section 3856, so Section 3840 now only provides guidance on accounting for non-financial items in a related party transaction.
- The scope of Section 3856 has been amended to make it clear that this 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 has also been added.

Initial Measurement

- Related party financial instruments are initially measured at cost, unless the instrument is equity that is quoted in an active market or a derivative contract. Such instruments are measured at fair value.
- The cost of a financial instrument in a related party transaction depends on whether the instrument has repayment terms.
- The election to initially measure financial assets or financial liabilities at fair value is prohibited for related party financial instruments.
- The equity component of a related party compound financial instrument is permitted to be initially measured as zero.

Subsequent Measurement

- Subsequent measurement of related party financial instruments has been aligned with initial measurement.

Presentation of Impairment and Forgiveness

- An enterprise is 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 is 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. Additional disclosure is required in this situation.
- For not-for-profit organizations, the forgiveness of a related party financial asset is recognized in the statement of operations through net income.

Modifications and Extinguishment

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

Additionally, an amendment was made to Section 3856 that requires all financial instrument risk disclosures to be prepared using enterprise specific information so that the disclosures provide information that is useful to financial statement users.

The amendments are required to be applied retrospectively, with simplified transitional provisions, for fiscal years beginning on or after January 1, 2020. Earlier adoption is permitted.

Narrow Scope Amendments - Income Taxes

The following minor amendments were recently made to Section 3465, *Income Taxes*:

- Effective January 1, 2017, the eligible capital property (ECP) rules in Section 14 of the *Income Tax Act* were repealed and replaced. As a result, the example in paragraph .14(f) of Section 3465, *Income Taxes*, which provided guidance on accounting for ECP was no longer relevant, so it was removed from the standard.
- When the future income taxes method is applied, Section 3465 previously required future income tax assets and future income tax liabilities to be split between current and non-current presentation. This requirement has been amended to only require non-current presentation for all future income tax assets and future income tax liabilities.
- An additional disclosure requirement was added to require the disclosure of the amount of future income tax assets and future income tax liabilities for each type of temporary difference for each period presented.

These amendments are effective for fiscal years beginning on or after January 1, 2020 and are to be applied retrospective.

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. There was confusion as to whether this initial measurement guidance would also be applicable when accounting for an interest in a jointly controlled enterprise using the cost method. As a result, paragraph 3051.07A was amended to clarify that it does apply to this situation.

This amendment is effective for fiscal years beginning on or after January 1, 2020 and is applied prospectively.

Projects on the Go

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. Based on the feedback received from stakeholders on the Exposure Draft the Board has decided to make the following changes to the proposals:

- Exclude forestry activities from the scope of the proposed standard;
- Replace the condition that costs of disposal must be "relatively insignificant" in order to measure agricultural inventories using the net realizable value model, with the condition that costs of disposal be "predictable and reliably measureable" instead;
- Allow the accounting policy choice to determine cost using only input costs, to be applied consistently to agricultural inventories measured using the cost model when they are "of a similar nature and use" rather than to "all" such agricultural inventories;
- Permit a retrospective change to the accounting policy for the determination of cost to change from full cost to only input costs; and
- Add illustrative examples to the proposed standard.

The Board is in the process of finalizing the standard and expects to issue it in the fourth quarter of 2019.

Exposure Draft - 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, in June 2019 the Board issued an Exposure Draft proposing additional guidance on the following areas be added to Section 3400:

- Bill-and-hold arrangements - guidance on how to determine if revenue can be recognized when the delivery of the goods or services has yet to occur;
- Multiple-element arrangements - guidance on how to identify the units of account and allocate revenue to these elements for multiple deliverable arrangements;
- Percentage of completion method - guidance on how to determine the degree of completion and compute the revenue to be recognized in a period;

- Reporting revenue gross or net - adding additional indicators to aid in determining whether revenue should be recognized on a gross or net basis; and
- Upfront non-refundable fees/payments - adding guidance on circumstances when revenue should be deferred.

Additional disclosures on the method used to measure the degree of completion of contracts and the aggregate amounts of costs incurred and profits recognized when the percentage of completion method is used are also proposed.

The proposals would be effective for fiscal years beginning on or after January 1, 2021, with earlier adoption permitted. The Board is aware of the difficulties that may arise in applying some of these amendments and is proposing transitional relief where in certain situations, an enterprise would not be required to make retrospective adjustments for long-term contracts accounted for using the percentage of completion method, or when accounting for multiple element arrangements.

The Board plans to review stakeholder feedback on the Exposure Draft and issue the final amendments in December 2019.

Project - Financial Statement Concepts

In March 2019, the AcSB approved a project to review the financial statement concepts in both Part II and Part III of the CPA Canada Handbook. The project will focus on:

- Elements (definition of an asset, liability, revenue and net assets);
- Recognition;
- Measurement;
- Disclosure; and
- Unit of account

The first items to be addressed will be the definition of an asset and liability with others to follow.

Project - Employee Future Benefits—Use of a Funding Valuation

In 2018, Ontario's pension regulator introduced a new reserve, the provision for adverse deviations (PfAD), in the going concern funding valuation for defined benefit plans. This reserve is meant to cover unexpected adverse deviations in such plans. Similarly, in 2016 Quebec enacted Bill 57, which eliminated the requirement to fund a pension plan on a solvency basis. Instead, plans are funded on a going concern basis with a new requirement to establish a reserve called a stabilization provision, the purpose of which is similar to that of the PfAD. Stakeholders have raised questions whether the PfAD and the stabilization provision should be included in the measurement of the defined benefit obligation when an entity makes an accounting policy choice to use a funding valuation under Section 3462. *Employee Future Benefits*, as there is currently diversity in practice.

The Board discussed this issue and clarified in a recent decision summary that both the PfAD and the Stabilization Provision should be included. This is because Section 3462 describes a funding valuation as being prepared in accordance with legislative, regulatory or contractual requirements. When legislative, regulatory, or contractual requirements stipulate calculations of various components of the funding requirement separately, it is the aggregate of those components that make up the funding valuation to be reflected in the financial statements. In Ontario, the PfAD (and in Quebec the stabilization provision) is one of those components of the funding valuation that would be included in the measurement of the defined benefit obligation.

Questions have also arisen on whether the PfAD/stabilization provision should be included in the measurement of the defined benefit obligation for unfunded defined benefit plans when a funding valuation is used. The Board initially concluded at its March 2019 meeting that it should, because paragraph 3462.029C requires that for these unfunded plans, the funding valuation used is an actuarial valuation prepared on a basis consistent with (i.e. the same basis as) the funding valuation used for the entity's funded plan(s). However, based on feedback received from outreach activities undertaken to date the Board believes the accounting policy choice in paragraph 3462.029C to measure unfunded defined benefit plans using a funding valuation should be removed since it is causing diversity in practice.

The Board plans to issue an Exposure Draft in the third quarter of 2019 proposing amendments to Section 3462, which would clarify the accounting for the above issues and propose the removal of the accounting policy choice in paragraph 3462.029C for unfunded plans as described above. Additionally, since there is diversity in practice in how the above issues are being accounted for, the Board plans to propose transitional relief in the Exposure Draft.

Project - Related Party Transactions

The results of an AcSB survey of stakeholders on the priority of projects for domestic standards identified Section 3840, *Related Party Transactions*, as a high priority since there has been confusion surrounding the guidance for certain related party transactions. The Board has already addressed the accounting for related party financial instruments, as discussed earlier in this publication. However, another area of concern identified by stakeholders was accounting for related party combinations. The Board is currently undertaking a research project to better understand the types of related party combinations undertaken by both private enterprises and not-for-profit organizations and the accounting challenges with these transactions. Once the results of the research project are determined, the Board will decide on next steps.

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.