ASSURANCE AND ACCOUNTING

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE) UPDATE 2017

Introduction

2017 may have seemed like a quieter year for the Accounting Standards Board (AcSB) and for Part II of the CPA Canada Handbook – Accounting: Accounting Standards for Private Enterprises (ASPE) as no new standards were issued. However, the Board was hard at work advancing the progress of various projects, including its project on agriculture and retractable or mandatorily redeemable shares issued in a tax planning arrangement. This publication will discuss these and other projects currently on the go as well as significant amendments made to Section 1591, *Subsidiaries*, and Section 3051, *Investments*, which will become effective in 2018.

Standards Effective in 2017

Subsidiaries & Interests in Joint Arrangements

The AcSB amended Section 1591, *Subsidiaries*, to clarify that when an enterprise makes an accounting policy choice to prepare non-consolidated financial statements, it is not required to assess its contractual arrangements for control over another enterprise.

Minor amendments were also made to both Section 1591 and Section 3056, *Interests in Joint Arrangements*, to clarify that the transitional relief in those Sections is only available when an entity transitions to the Sections for the first time (or in the year an entity adopts ASPE for the first time).

These amendments are effective for fiscal years beginning on or after January 1, 2017.

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 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, *Business Combinations*.
- 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 required 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, such as scope, reclassification and measurement. 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.

Original Exposure Draft

Withdrawal of paragraph 3856.23 would require these types of retractable or mandatorily redeemable shares to be presented as a liability, consistent with other financial liabilities. The liability would be initially measured at fair value. The corresponding debit would be presented as a separate component of equity. As the shares are redeemed, the balance in this separate category of equity would be reclassified to retained earnings. Information on the origin of this separate component of equity and its relationship to the shares would be disclosed. The liability would be subsequently measured at amortized cost, unless the redemption provisions are linked to the performance of the entity. The proposed change would have a significant impact on entities following ASPE that have retractable or mandatorily redeemable shares that currently fall under paragraph 3856.23, as there would be an increase in the total amount of liabilities and a decrease in the total amount of equity. For example, the proposed change in presentation and measurement could have a significant effect on debt covenants and may require renegotiation of lending agreements prior to the date this change would be effective.

Feedback & Re-exposure Draft

Due to the impact this change could have, the AcSB received a large number of responses to the Exposure Draft and also obtained a significant amount of feedback through several round tables held across the country. As a result of the feedback, the Board has been considering whether an exception for classification of retractable or mandatorily redeemable shares issued in a tax planning arrangement based on retention of control over the enterprise would be viable. Field testing of this option has been performed and this fall the Board issued a Re-exposure Draft proposing 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.

If approved the proposed effective date for the amendments would be fiscal years beginning on or after January 1, 2020. Retrospective application would be required in accordance with Section 1506, *Accounting Changes*, but an option to not restate comparative financial information would be provided.

Based on what the Board is proposing, some of the tax planning arrangements that meet the classification exception under the current guidance in paragraph 3856.23 would no longer qualify for the exception under the proposed changes. As a result, we would encourage stakeholders to provide their views on the proposals, which can be accessed here, to the AcSB by the response date of January 15, 2018.

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. 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. The Discussion Paper outlined the Board's proposed view on the scope of this project, when biological assets should be recognized, how they should be measured and how they should be presented and disclosed. Measurement of biological assets is the area where there is currently the most diversity in practice and is the most contentious issue. The Discussion Paper provided an analysis of using either cost or current value to measure unharvested crops, agricultural produce, animals held for sale, bearer animals and bearer plants. The Discussion Paper and related the related roundtables that were held sought feedback on whether stakeholders agreed with the Board's view on each issue.

In early 2017, the Board formed an Agriculture Advisory Group, which consists of a number of individuals with range of background experiences including farmers, preparers, practitioners, users, government employees and academics. The group will act in an advisory capacity to assist the Board in developing standards for the agricultural sector. The Board and the advisory group have been hard at work during the past few months. As a result of the feedback provided and discussions with the advisory group, the Board has decided:

- That the scope of the proposed agriculture guidance should be similar to that provided by US GAAP, which defines and refers to agricultural producers, rather than agricultural activity. This would result in agricultural inventories being within the scope of the project as long as they are held by an enterprise that is an agricultural producer, regardless of whether or not they are the output of that enterprise's agricultural activity;
- The definition of agricultural producers should be expanded to explicitly include aquaculture;
- Agricultural producers should measure agricultural inventories at current value when conditions are met or at cost and productive biological assets should be measured at cost. The option to use either direct costs or full costs when determining cost would be provided; and
- The most appropriate measure for current value for agricultural inventories is net realizable value.

An Exposure Draft is currently being developed and is expected to be issued in 2018. To keep up to date with the latest information on this project and to see the details of what has been discussed at the agriculture advisory group meetings, check out the agriculture project page on the Financial Reporting & Assurance Standards Canada website or click here.

Narrow Scope Amendments – Financial Instruments

In 2014, the AcSB issued its Post-implementation Review: Section 3856, *Financial Instruments*. Based on the feedback provided the Board understands 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 is not entity-specific and therefore is not providing useful information. As a result, the Board has taken on a narrow scope amendment project which will consider:

- Clarifying the scope of related party financial instruments;
- Initial measurement of related party financial instruments;
- Clarifying the measurement of related party compound financial instruments;
- Classification of impairment and forgiveness of related party loans;
- The scope of accounting for modifications and extinguishments of related party loans; and
- Usefulness of financial instrument risk disclosures.

The Board plans to issue an Exposure Draft on these issues in the fourth quarter of 2017.

Consultations on Priorities for Part II

While developing its 2016-2021 Strategic Plan and through consultations with stakeholders, the AcSB has received feedback on concerns with ASPE. As a result, the Board identified a number of topics which it is considering undertaking as future projects. The Board is currently performing targeted outreach activities to gain a better understanding of the issues related to these topics. For example, a survey on revenue was performed earlier this year. The Board will then consider the feedback obtained from these outreach activities when determining the timing and scope of future projects.

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.