Flash - ASPE

March 2017

Flash bulletins provide a summary of the most recent news and publications from standard setters on accounting standards for private enterprises (ASPE), not-for-profit organizations (NFPO) and pension plans. This version of *Flash* specifically addresses ASPE. The version of *Flash* specifically addressing NFPO can be accessed from the Grant Thornton Canada website.

This publication is intended to inform readers about recent changes in accounting; however, it cannot deal with all topics. Readers are always encouraged to refer to the original publications mentioned in the articles before making any decisions.

2017 Annual Improvements

In September 2016, the Canadian Accounting Standards Board (AcSB) issued an Exposure Draft entitled *2017 Annual Improvements to Accounting Standards for Private Enterprises* as part of the annual ASPE improvements process that aims to clarify guidance or wording and to correct for unintended consequences, conflicts or oversights. The proposed amendments could also apply to NFPO that apply Part III of the *CPA Canada Handbook – Accounting*.

The final amendments are expected to be issued in the third quarter of 2017 and effective for years beginning on or after January 1, 2018. Earlier adoption would be permitted.

Below is a summary of the amendments that were proposed:

- Section 1505 *Disclosure of Accounting Policies* currently requires an entity to disclose its accounting policies in the first note to its financial statements. The proposed amendment would provide more flexibility by requiring the presentation of accounting policies in one of the first notes to the financial statements.

- Currently, when an entity changes an accounting policy, it must disclose the amount of the adjustment to each financial statement line item affected for the current period. The proposed amendment, however, would require disclosure of the amount of the adjustment for each financial statement line item related to a change in accounting policy "for each of the prior period(s) presented".

- Section 1521 *Balance Sheet* is intended to summarize the presentation requirements found in all the other standards within ASPE and identifies certain items that are required to be presented separately on the balance sheet or in the notes to the financial statements. The amendments propose changes to some of the items that currently require separate presentation on the balance sheet. For example, the proposed amendments would clarify the existing presentation of assets under capital lease by stating that these assets may be presented on the face of the balance sheet or in the notes to the financial statements.

- Section 1651 *Foreign Currency Translation* currently states that previous write-downs of inventories related to an integrated foreign operation cannot be reversed. This requirement contradicts the requirements in Section 3031 *Inventories* which requires the reversal of previous write-downs to inventories when the circumstances that caused the write-down no longer exist or there is clear evidence of an increase in the net realizable value. The AcSB proposes an amendment to Section 1651 to make it consistent with Section 3031 by allowing the reversal of write-downs of inventories of an integrated foreign operation.
- The last proposed amendment would remove the requirement to disclose the carrying amount of impaired operating lease receivables in Section 3065 *Leases*.

Our thoughts
The amendments proposed in the 2017 Annual Improvements project are fairly minor and non-controversial. If approved as exposed, these amendments are not expected to have a significant impact on most reporting entities.

Clarifications to Sections 1591 and 3056

In December 2016, the AcSB issued narrow-scope amendments to Section 1591 *Subsidiaries* and Section 3056 *Interests in Joint Arrangements*. The amendments clarify

- the application of the transitional provisions of Sections 1591 and 3056;
- when an entity has to assess contractual arrangements for control; and
- the accounting for voting interests and potential voting interests in an unconsolidated subsidiary that is controlled through voting interests, potential voting interests or a combination thereof, in combination with contractual arrangements.

Application of transitional provisions of Sections 1591 and 3056

The transitional provisions in Section 1591 provide relief for enterprises that

- prepared consolidated financial statements previously and are required to consolidate one or more additional subsidiaries for the first time upon adoption of Section 1591;
- choose to prepare consolidated financial statements for the first time upon adoption of Section 1591; and
- are no longer consolidating a subsidiary that was previously consolidated.

Section 3056 includes transitional provisions to provide relief for enterprises that transition from proportionate consolidation to the cost or equity method, or from the cost or equity method to accounting for the investor's interests in the individual assets and liabilities of a joint arrangement.

The amendments clarify that these transitional provisions were developed to provide relief only on transition to the new standards and when an enterprise prepares its first financial statements in accordance with ASPE. As a result, enterprises cannot apply the transitional provisions in either of these standards when they change their accounting policy choice subsequent to their initial adoption of Sections 1591 and 3056.

These amendments are effective for fiscal years beginning on or after January 1, 2017, and earlier adoption is permitted.

Assessing contractual arrangements for control

This amendment clarifies that an entity does not have to assess whether any contractual arrangements it has with other entities result in a control relationship when it chooses to prepare non-consolidated financial statements.

This amendment is effective for fiscal years beginning on or after January 1, 2017; earlier adoption is permitted.

Accounting for a subsidiary controlled through contractual arrangements in combination with voting interests and/or potential voting interests

Section 1591 was unclear pertaining to how an enterprise preparing non-consolidated financial statements accounts for its voting interests and/or potential voting interests in a subsidiary that it controls through voting interests, potential voting interests, or a combination thereof, in combination with contractual arrangements. The amendment clarifies that any voting interests and potential voting interests that an investor holds in a non-consolidated subsidiary are accounted for using the cost method or equity method.

This amendment is effective for fiscal years beginning on or after January 1, 2018; earlier adoption is permitted.

Our thoughts

The transition to Section 1591 and/or 3056 can be quite complex. These amendments do not add to the complexity of the standard. Rather, they are intended to clarify existing guidance. The amendments to the transition provisions in Sections 1591 and 3056 are mandatorily effective one year after Sections 1591 and 3056 themselves are effective. Nonetheless, we recommend that private enterprises early adopt these amendments on transition to the new standards for fiscal years beginning on or after January 1, 2016 in order to gain the benefit of the resulting clarifications to the transition approach.

Subsidiaries and Investments

In December 2016, the AcSB issued amendments to Section 1591 and Section 3051 *Investments* which provide guidance relating to the accounting for an investment in a subsidiary and an investment in an entity subject to significant influence when the investor chooses to apply the cost method.

The amendments made to Section 1591

- set out the underlying principle that an interest in a subsidiary that is subsequently accounted for using the cost method is initially measured on a basis that is similar to other business combinations;
- provide guidance on:
  - how to apply the cost method for investments in subsidiaries in accordance with this underlying principle, including the fact that an enterprise does not recognize bargain purchase gains and measures acquisitions of additional interests at cost
  - the subsequent measurement of an interest in a subsidiary; and
- provide disclosure requirements when an enterprise chooses to account for its subsidiaries by applying the cost or equity method.

The amendments made to Section 3051 add guidance on

- how to apply the cost method to investments in entities subject to significant influence, including the requirement to initially measure the investment at the fair value of the consideration transferred; and
- indicators of impairment arising from the acquisition of an additional interest, sale of a portion of an interest or dilution of an investor's interest in an investee.

In addition to these significant changes, some minor consequential changes were made to Section 1500 *First-time Adoption* and Section 1582 *Business Combinations*.

The amendments are effective for fiscal years beginning on or after January 1, 2018, however earlier application is permitted. The amendments must be applied prospectively, with one exception.

AcSB and Private Enterprise Advisory Committee projects and activities

The AcSB is continuing various projects to amend ASPE in order to preserve the quality and credibility of private enterprises' financial statements. To accomplish this task, the AcSB is supported by the Private Enterprise Advisory Committee (the Committee). Grant Thornton LLP currently has a member serving on the Committee. The following paragraphs summarize certain topics discussed at meetings held by the AcSB and the Committee since June 2016.

Agriculture

In October 2016, the Committee discussed the feedback received in response to the AcSB's Discussion Paper, "Agriculture". The Agriculture project is intended to introduce specific guidance into ASPE on accounting for biological assets and agricultural produce for the agricultural sector. For more information on the preliminary proposals, consult the June 2016 *Flash* bulletin.

Although a majority of respondents supported the AcSB's preliminary view that it should develop authoritative guidance for the agricultural sector to improve comparability in financial reporting in the sector, stakeholders raised several issues through comment letters and roundtable discussions. Some of the concerns raised included:

- **Project scope:** In the opinion of some respondents, purchased agricultural produce, quotas and land should be included in the project scope.
- **Measurement:** Some respondents suggested that the guidance on measurement should follow a principles-based approach for all biological assets and agricultural produce, rather than a mixed measurement model as proposed. Alternatively, some stakeholders suggested allowing an accounting policy choice to measure agricultural assets, as permitted under US generally accepted accounting principles (GAAP).
- **Recognition and measurement of unharvested crops:** Respondents noted that there is significant uncertainty regarding the future benefits to be obtained from unharvested crops and, as a result, many respondents disagreed with recognizing unharvested crops as an asset and measuring that asset at cost in ASPE financial statements.
- **Measurement of bearer animals:** The majority of respondents disagreed with the proposal that bearer animals should be measured at cost and emphasized that there are significant complexities in determining the cost. Respondents also indicated that measuring bearer animals differently than animals held for sale could pose a problem in practice, particularly when the intended use may be uncertain, or could change based on market conditions.
- **Change in use:** Respondents raised concerns about the preliminary view that would require re-measurement of certain biological assets should there be a change in use (e.g., from a bearer animal measured at cost to an animal held for sale measured at current value).

Neither the Committee nor the AcSB has made any decisions pertaining to the respondents' comment to date.

In December 2016, the AcSB approved a standards-level project to develop authoritative guidance and it expects to issue an Exposure Draft in 2018. To assist it with developing accounting standards for the agricultural sector, the AcSB has decided to create an agriculture advisory committee.

Redeemable preferred shares issued in a tax planning arrangement

In June, July and December 2016, the Committee and the AcSB further discussed the classification exception (as equity rather than a liability) for redeemable preferred shares issued in a tax planning arrangement (the classification exception), as well as conditions under which such an exception might be permitted. One of the solutions being considered is to base the classification exception on the retention of control of an enterprise. To determine the viability of this solution, the AcSB requested field testing to assess whether the control guidance in Section 1591 is sufficiently robust to address the various characteristics of tax planning arrangements.

In January 2017, the AcSB decided, based on the results of field testing, that the classification exception should be based on the condition of retention of control of an enterprise. The AcSB also concluded that additional guidance may be needed relating to the control assessment and that other conditions would be have to be met in order to qualify for the classification exception.

The AcSB noted that at least some of the tax planning arrangements that meet the classification exception under the current guidance will not qualify for the exception under the proposed basis. The effect of its decisions on current practice will be investigated.

Our thoughts

Should amendments proceed on the basis of a retention of control model, some private enterprises that currently present their redeemable preferred shares issued in a tax planning arrangement as equity will be required to present the shares as a liability measured at the redemption amount instead. A common example of a tax planning arrangement whose redeemable preferred shares are not expected to qualify for equity presentation under a retention of control mode is an asset rollover. Such a change in presentation could have a significant impact on an entity's reported financial position and results of operations.

Post-implementation Review: Section 3856 *Financial Instruments*

In October 2014, the AcSB undertook a post-implementation review of Section 3856 *Financial Instruments* and, in September 2015, published a Feedback Statement summarizing the results of this review. In June 2016, the Committee discussed the feedback from stakeholders and agreed to suggest to the AcSB that it add the issues noted below to the AcSB's project plan so they can be addressed through either a major project or a narrow-scope amendment:

- accounting for related party financial assets and financial liabilities after initial recognition
- measuring related party compound financial instruments
- classification of impairment and forgiveness of related party loans
- determination of the carrying amount or exchange amount of newly issued related party financial instruments
- classification of certain instruments as either equity or financial liabilities
- revisions to certain disclosure requirements

The Committee also agreed to suggest to the AcSB that it should carry out further research on the issues noted below:

- initial measurement of financial instruments with non-market conditions or uncertain cash flows

- determination of fair value for certain financial assets (including mutual or pooled funds)

The Committee noted that the latter issue is prevalent with NFPO and, accordingly, suggested that it be raised with the Not-for-Profit Advisory Committee.

At its January 2017 meeting, the AcSB approved a project to address several narrow-scope issues such as the scope of related party transactions, measurement of related party compound financial instruments and disclosure. In addition, stakeholders will be asked to provide feedback about the relative priorities for Part II for other topics, such as

- fair value measurement,
- hedge accounting, and
- derecognition and classification of financial liabilities and equity.

The AcSB agreed that if these topics are added to its work plan, they would need to be addressed through major projects.

Consultation on priorities for Part II

One of the AcSB's expected activities described in its *2016-2017 Annual Plan* is to consult with stakeholders about its relative priorities for future projects relating to ASPE. In September 2016, the AcSB decided to focus its efforts on the following specific topic areas at this time:

- Section 1000 *Financial Statement Concepts*
- Section 3400 *Revenue*
- Section 3840 *Related Party Transactions*

In December 2016, the Committee noted the following with regards to two of these topics:

Revenue

Applying the principles of the revenue standard in its current form is challenging and there is an increased need to refer to other frameworks for additional guidance. The following types of transactions were highlighted as requiring further discussion:

- construction contracts
- multiple-element arrangements
- up-front, non-refundable fees
- loyalty programs
- bill-and-hold arrangements
- subscription sales
- contract modifications

Our thoughts

In 2014, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) issued IFRS 15 *Revenue from Contracts with Customers* and ASC 606 *Revenue from Contracts with Customers*, respectively, to replace existing revenue guidance in International Financial Reporting Standards (IFRS) and US GAAP. These new standards will be effective in 2018 or 2019 (depending on various factors).

At first glance, the upcoming change in IFRS and US GAAP would seem to have no impact on ASPE, whose own revenue recognition standard has not changed. However, Section 3400 *Revenue* in ASPE is a principles-based standard with little detailed guidance, so many entities currently look to IFRS and/or US GAAP for clarifying guidance.

IFRS 15 and ASC 606 are both based on a transfer of control model, rather than the transfer of risks and rewards model that ASPE, IFRS and US GAAP currently use. Therefore, after the effective date of IFRS 15 and ASC 606, entities will need to assess whether it remains appropriate to refer to IFRS and US GAAP when a matter is not dealt with explicitly in ASPE.

Related party transactions

Accounting for related party transactions is particularly challenging in the following areas:

- interaction of Section 3840 with other Sections within ASPE,
- determination of the carrying amount in certain circumstances, and
- presentation and disclosure.

Discussions on all of the above topics are expected to continue at future meetings of the Committee and the AcSB.

Review of recently issued standards under other accounting frameworks

The Committee and the AcSB reviewed standards recently issued by other standard setters, including the US Financial Advisory Standards Board and the International Accounting Standards Board, to consider whether some or all of those standards would provide significant benefit to Canadian private enterprises in their financial reporting. In January 2017, the AcSB decided to include the following topics in its consideration of priorities for ASPE:

- amortization of goodwill
- recognition of intangible assets in business combinations
- definition of a business

The AcSB also directed staff to research whether allowing the application of push-down accounting in more situations than currently permitted by Section 1625 *Comprehensive Revaluation of Assets and Liabilities* would provide significant benefits to stakeholders. Lastly, the staff were directed to consider a project that would address the presentation of current and non-current future income tax assets and liabilities. The AcSB agreed that projects addressing the following topics would not be undertaken at this time:

- recognition of cloud computing fees
- leasing under IFRS and US GAAP
- a revaluation model for property, plant and equipment

Impairment – allocation of an impairment loss

Section 3063 *Impairment of Long-lived Assets* and Section 3064 *Goodwill and Intangible Assets* provide limited guidance on how impairment losses should be allocated between long-lived assets and goodwill when they are assessed for impairment at the same time at the reporting unit level. In June 2016, the Committee discussed this issue and agreed to suggest to the AcSB that this issue warrants further consideration.

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The information in this publication is current as of March 1, 2017.

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