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Year end ASPE update for private enterprises

December 11, 2018

Audit

Important caveats

This webcast does not provide official Deloitte interpretive accounting guidance.

Please check with your advisor before taking any action.

No certificates are provided for viewing; we encourage stakeholders to check with their provincial institutes regarding potential CPD credits.

Contents

ASPE amendments effective January 1, 2018

Changes to the cost method

Which investments does this impact?

Does the entity have these investments?

Subsidiaries (control)	Investments with significant influence	Interests in jointly controlled enterprises (joint control)
	Accounting policy choices	
1. Consolidation 2. Equity method 3. Cost method	1. Equity method 2. Cost method	1. Equity method 2. Cost method 3. Analyze each interest separately

Amendments are applicable prospectively for fiscal years beginning on <u>after</u> January 1, 2018!

Changes to the cost method (cont'd)

What you need to know

No change in definition

The **cost method** is a basis of accounting for investments whereby the investment is initially recorded at cost; earnings from such investment are recognized only to the extent received or receivable

Initial measurement	Subsidiaries	Investments
• **Cost** is measured at the **acquisition-date fair value** of the consideration transferred for the investment	●	●
• If **only equity interests** are exchanged, use fair value of the more reliably measurable equity	●	●
• A **bargain purchase gain** is not recognized	●	
• In a step-acquisition, the **previously held interest** is not re-measured	●	●
• **Acquisition-related costs** are expensed	●	●
• Costs related to the settlement of **pre-existing relationships** are not a cost of the investment	●	
• **Provisional amounts** may be used when initial accounting for the acquisition is incomplete	●	

Changes to the cost method (cont'd)

What you need to know

Subsequent measurement	Subsidiaries	Investments
• Recognize **earnings** when received or receivable	●	●
• **Provisional carrying amount** to be finalized within a year from the acquisition date, but not retrospectively adjusted	●	
• **Contingent consideration** is re-measured when the contingency is resolved, on the same basis as is required by Section 1582	●	
• Upon **disposal of a portion of the held interest,** the remaining carrying amount is calculated as a proportionate share of the carrying amount of the investment immediately prior to the disposal	●	
• **Impairment considerations** when there is a purchase/sale/dilution of the investment	●	●

Changes to the cost method (cont'd)

What you need to know

Other highlights

- **Common control transactions** are accounted for at carrying value as a related-party transaction (Section 3840), unless specific criteria are met
- **Disclosure** requirements have been added which apply when a company prepares non-consolidated financial statements

Acquisition of a subsidiary

Example 1 – Unbundling the purchase price

- On December 1, 2018, Company A acquires 100% of the shares of Company B (i.e. it acquires control) and applies the cost method to account for its subsidiaries.
- Company B is in the business of developing smart phone apps, and is wholly owned by a single shareholder who is also the CEO.

Purchase price:

- Initial cash payment of $1 million
- Additional payment of $200,000 to the former owner if Company B exceeds specified EBITDA levels for the two year period following the acquisition. The agreement stipulates that the former owner will forfeit any rights to the additional payment if he leaves Company B before the end of the two year period. Company A believes that the services of the CEO are critical to the successful transition of Company B.

Question:

What is the cost of Company A’s investment in Company B on December 1, 2018?

Acquisition of a subsidiary (cont'd)

Example 1 – Unbundling the purchase price

Analysis:	
Initial cost of subsidiary on December 1, 2018:	
• Cash payment	$1,000,000
Total initial cost of investment	**$1,000,000**

Additional payment to seller:	**$200,000**

Contingent consideration? Compensation?

"A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination service" (Section 1582.A49(a))

Answer: Payment is forfeited if CEO terminates – therefore expensed as compensation. Carrying amount of investment is $1,000,000.

If payment was not automatically forfeited if employment terminates, need to consider remaining factors in Section 1582.A49 to determine if payments are contingent consideration.

Acquisition of a subsidiary (cont'd)
Example 2 – Working capital adjustment

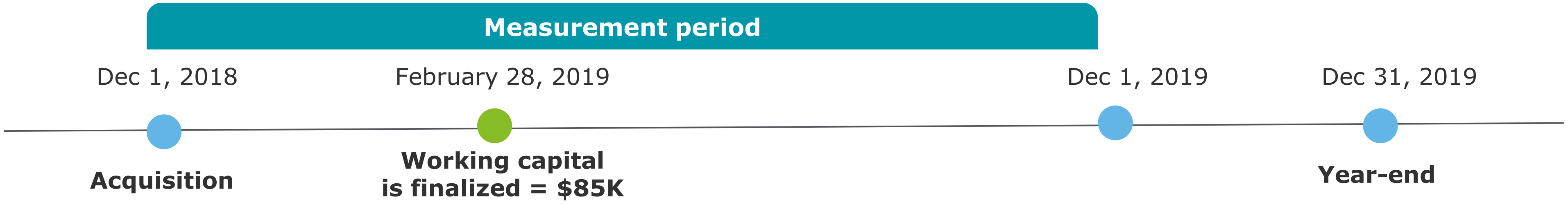
- Same facts as Example 1, except there is a working capital adjustment clause
- Clause states: "The purchase price is $1.0 million plus estimated working capital at December 1, 2018 of $65,000. The Company has 90 days to finalize the working capital as of the acquisition date, and if there is a difference, the purchase price will be adjusted accordingly."

Question: What is the carrying amount of the investment at December 31, 2018?

Analysis:	
Cash payment	$1,000,000
Estimated working capital	65,000
Initial cost of investment	$1,065,000

Acquisition of a subsidiary (cont'd)

Example 2 – Working capital adjustment



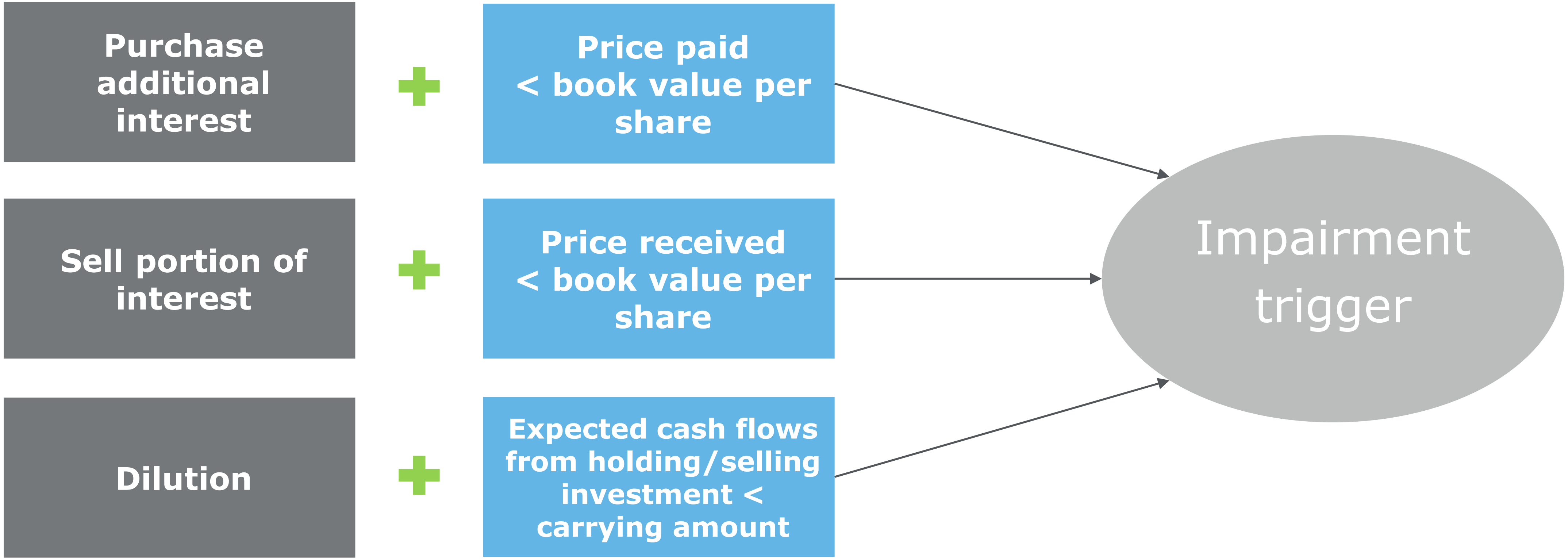
Question: What is the carrying amount of the investment at December 31, 2019?

Analysis:	
• Original cost at December 1, 2018	$1,065,000
• Working capital adjustment ($85K-$65K)	20,000
Total cost of investment	$1,085,000

Prospective adjustment.
No restatement!

Working capital adjustment is a "*measurement period adjust*ment" (i.e., more information about conditions existing at acquisition date, that affect the purchase consideration).

Changes in ownership interests



New triggers of impairment – for investments accounted for using the cost or equity method!

Changes to the cost method

Key considerations

- Careful analysis of purchase transactions will be necessary, particularly of subsidiaries
- For example, if company enters into arrangements during negotiation for the acquisition of a subsidiary (e.g. arrangements to remunerate former owners/key employees for future services) need to evaluate if these transactions are separate from the acquisition of a subsidiary
- Watch out for impairment triggers on changes in ownership interests

2018

Annual improvements to ASPE

Disclosure of accounting policies

Disclose accounting policies
in one of the first notes versus
the first note

Accounting changes

Disclose impact of change in accounting policy for each **prior period** presented, versus the current period

Balance sheet

Clarify items requiring separate presentation in balance sheet versus disclosure in the notes

Foreign currency translation

Permit reversal of an inventory write down in an integrated foreign operation

Leases

Lessors required to disclose allowance on impaired operating lease receivables (not carrying amount)

Effective for fiscal years beginning on or after January 1, 2018.

Upcoming changes to ASPE

ASPE work plan
Active projects

	2018		2019	
Major improvements	**Q3**	**Q4**	**Q1**	**Q2**
• Agriculture	**ED**			
• Consultation on priorities for Part II				
• Retractable or mandatorily redeemable shares issued in a tax planning arrangement		**HB**		
Narrow-scope amendments				
• Financial instruments		**HB**		
• Income taxes	**ED**			
• Investments	**ED**			
• Revenue				**ED**

Status based on AcSB workplan as at November 29, 2018
http://www.frascanada.ca/standards-for-private-enterprises/projects/active/item56206.aspx

ED= Exposure Draft

HB= Handbook Release

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

Currently

- Preferred shares which are issued in a tax planning arrangement under Sections 51, 85, 85.1, 86, 87 or 88 of the Income Tax Act and are redeemable at the option of holder are **classified as equity**
- **Measure at par, stated or assigned value.**
- Shares are reclassified to liabilities when redemption is demanded. (Section 3856.23)

Why was a change needed?

- Exception from liability treatment was being applied more broadly than intended
- Some shares were excluded from Section 3856.23 because they were not issued under one of the ITA sections

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

New model

Retractable or mandatorily redeemable shares issued in a tax planning arrangement are **classified as equity** only when these conditions are met:

Control		**Only consideration exchanged is shares**		**No other arrangement specifying redemption**
• Control of enterprise issuing the retractable or mandatorily redeemable shares is retained by shareholder receiving the shares. • Substantive rights	+	• Only consideration exchanged is one class of shares for another class of shares of issuing enterprise	+	• No other arrangement exists that gives holder the right to require redemption on fixed or determinable date (e.g. a redemption schedule).

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

New model

All 3 conditions met?

Yes

No

Equity

- Measure at par, stated or assigned value
- Re-assess for events that could threaten any of the 3 conditions
- If conditions are no longer met, reclassify as liabilities

Liability

- Measure at the redemption amount
- Classify shares as current liabilities (as due on demand)
- Do not reclassify to equity

Note: The AcSB tentatively decided to provide an **option** to classify shares as financial liability even if all 3 conditions could be met.

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

New model

Which transactions involving the issuance of retractable or mandatorily redeemable shares in a tax planning arrangement **are expected to qualify** for **equity classification?**

- ✓ Estate freeze transactions that meet all 3 conditions
- ✗ Asset rollover transactions

Example 1 – Estate freeze

Before

Shareholder X

10 Common shares (10% voting rights)

Shareholder Y

90 Common shares (90% voting rights)

Company A

After

Shareholder X

10 Common shares (10% voting rights)

Shareholder Y (Freezor)

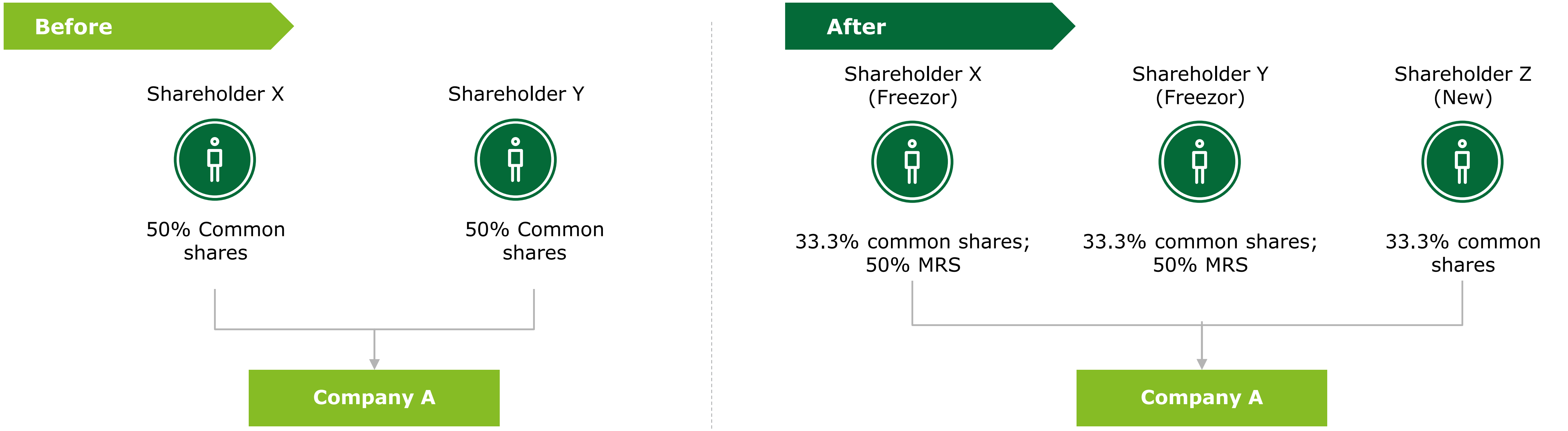
Retractable or mandatorily redeemable shares (value 90% of equity and 90% voting rights)

Company A

- Retain control?
- Only shares?
- No other arrangement specifying redemption?

Equity

Example 2 – Estate freeze



Common shares represent equal voting interest; decisions on the strategic operating, investing and financing policies require the consensus of all shareholders. MRS: mandatorily redeemable shares.

- ✗ Retain control?
- ✓ Only shares?
- ✓ No other arrangement specifying redemption?

→ **Financial Liability**
(due to joint control)

The AcSB has tentatively decided to provide guidance on determining a "related party unit of account".

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

Effective date and transition

Effective for fiscal years beginning on or after January 1, 2020, applicable retrospectively.

- Assess whether conditions for equity classification are met **on the date amendments are applied for the first time** (i.e., not original date of transaction)
- Transitional relief is available
  - Not required to assess shares redeemed before the effective date
  - Option to not restate comparatives
  - Shares issued in tax planning arrangements before January 1, 2018 do not have to meet the 'share only' condition to qualify for equity treatment (tentative Board decision)

Exposure Draft
Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

Example – Transition

- Shareholder X and Y own 70% and 30% respectively of voting common shares of Company A.
- In 2015, Shareholder Y executed an estate freeze where he exchanged his 30% common shares for mandatorily redeemable shares in Company A (30% value of equity):
    - Par value = $100
    - Redemption value = $1000
    - Shares were classified as equity under Section 3856.23
- Shareholder X had control before and after the transaction.
- Shares would need to be reclassified to liabilities on transition (as shareholder receiving the mandatorily redeemable shares does not control the company before or after).

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

Example – Transition

Before	
Liabilities:	
Accounts payable	50
Equity:	
Tax planning shares	100
Common shares	400
Retained earnings	885

After	
Liabilities:	
Accounts payable	50
Tax planning shares	1,000*
Equity:	
Effect of classifying tax planning shares as liabilities	(900)**
Common shares	400
Retained earnings	885

* At the redemption amount. Future income tax effects ignored.
** Alternatively through retained earnings as per the AcSB tentative decision in 2018.

Exposure Draft

Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

Key considerations

- Do you have any outstanding retractable or mandatorily redeemable shares issued in a tax planning arrangement?
- Would they meet the conditions for classification as equity?
- If not, what impact would this have on your financial statements (e.g. financial covenants, key performance ratios)?
- Read the final amendments … including the transitional provisions for relief available on adoption!

Accounting for related party financial instruments and significant risk disclosures

Exposure Draft
Accounting for related party financial instruments and significant risk disclosures

Introduction

- Challenge exists in measuring financial instruments issued or received in a related party transaction
- Examples: loans, receivables/payables, common shares, preferred shares, warrants
- Section 3840, *Related Party Transactions,* only deals with the “Day 1” measurement
- Amendments are intended to simplify the accounting for financial instruments, when transferred among related parties

Amendments apply to private companies and NFPOs (applying Part III)

Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

What's the new model?

- Equity and debt instruments quoted in an active market*
- Debt with observable inputs*
- Derivatives

→ **Fair value**

- All other related party financial instruments

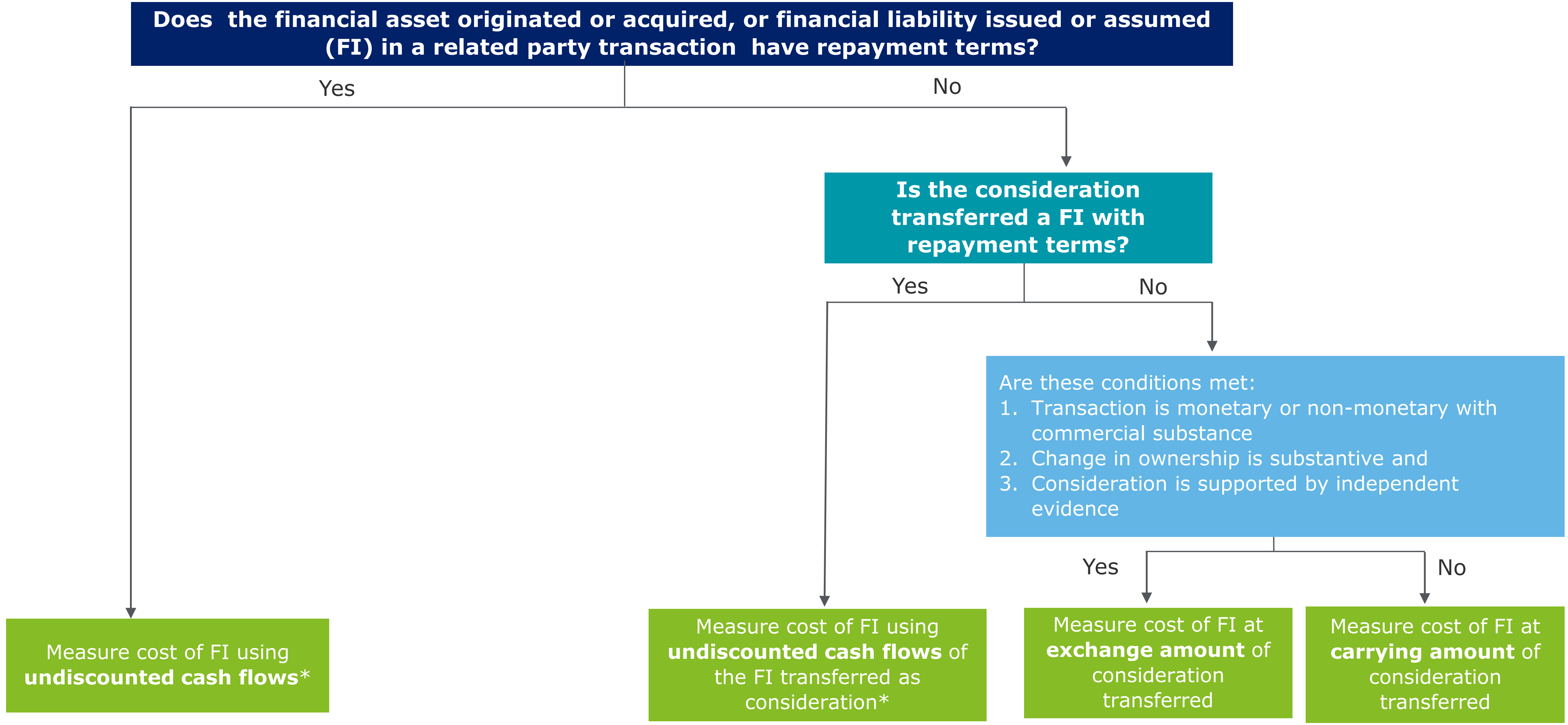
→ **Cost** less reduction for impairment

* The AcSB tentatively decided in 2018 that **debt instruments quoted in an active market** and **debt with observable inputs** should initially be measured at fair value. Policy choice to subsequently measure them at fair value or amortized cost.

Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

How is "cost" determined?



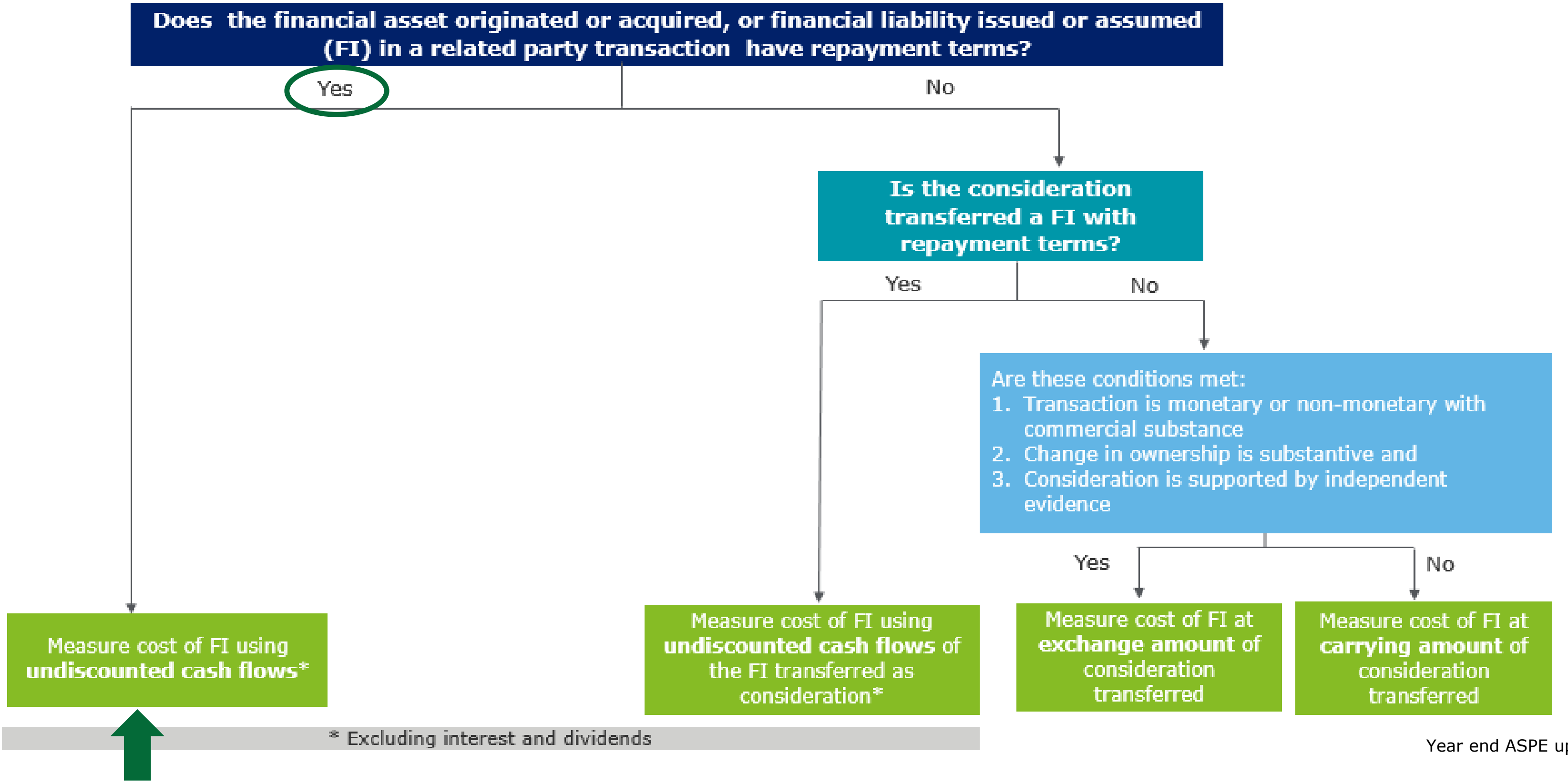
* Excluding interest and dividends

Exposure Draft
Accounting for related party financial instruments and significant risk disclosures (cont'd)
Example 1 – Related party loan

- Parent company advances its subsidiary $100,000 in cash and receives as consideration a note receivable
- Face amount of note = $100,000. No maturity date. No specified terms of repayment. Note is not quoted in an active market, does not have observable inputs.
- *Note: debt with no stated repayment terms is deemed payable on demand (Section 3856.A12)*

Question: How should the cost of the note be measured?

Measure cost of the ***note*** at the undiscounted cash flows of the note.



Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

Example 1 – Related party loan

Entries to be recorded:

Parent company		Subsidiary	
Dr. Note receivable	$100,000	Dr. Cash	$100,000
Cr. Cash	$100,000	Cr. Note payable	$100,000

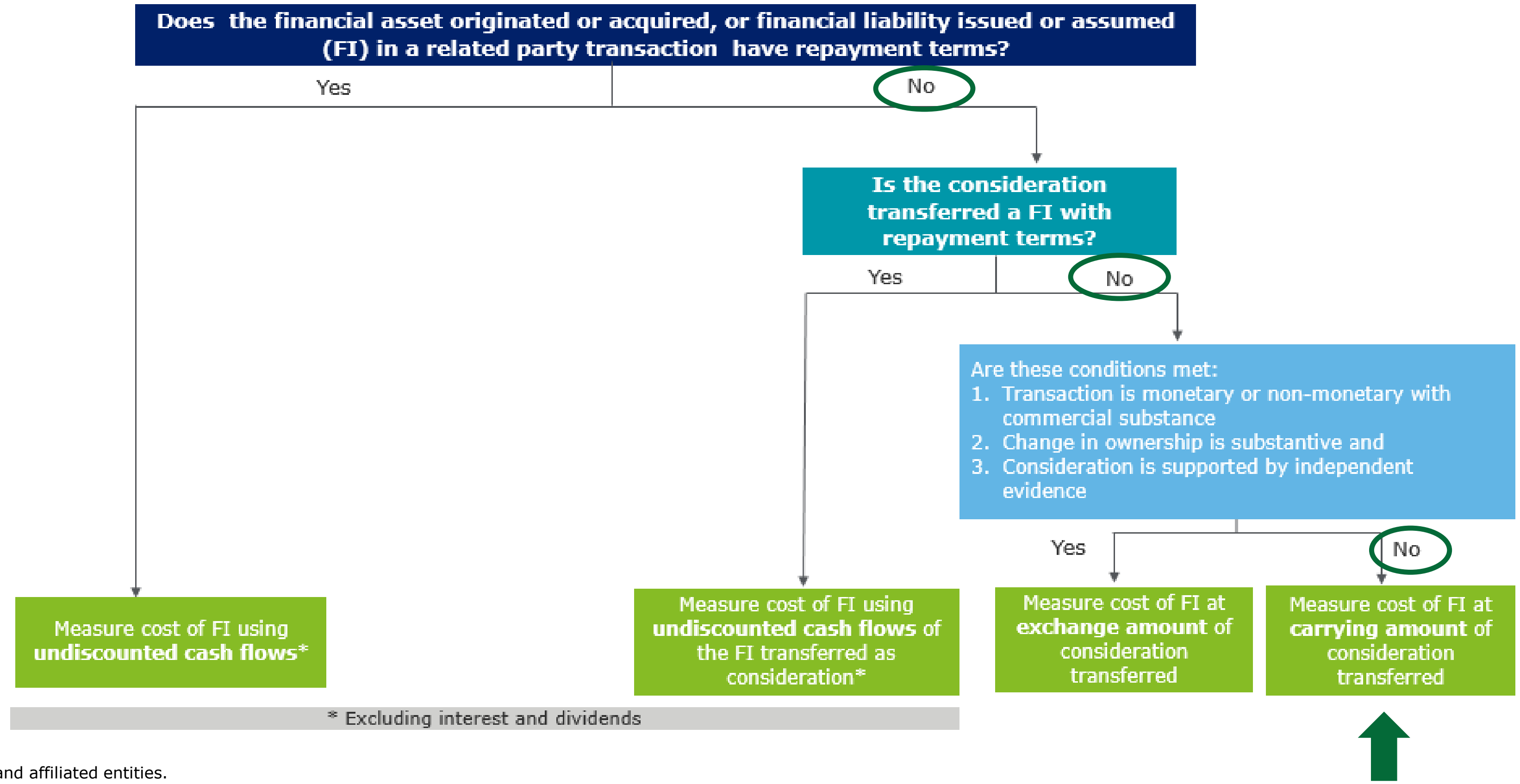
Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

Example 2 – Transfer of land for shares

- Parent company transfers land to its wholly owned subsidiary and receives as consideration common shares in the subsidiary
- Carrying amount of the land = $90,000

Question: How should the cost of the common shares be measured?



Measure cost of the common shares at carrying amount of consideration transferred (i.e. the land).

Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

Example 2 – Transfer of land for shares

Entries to be recorded:

Parent		Subsidiary	
Dr. Investment in subsidiary	$90,000	Dr. Land	$90,000
Cr. Land	$90,000	Cr. Common shares	$90,000

The amendments do not impact how non-financial instrument consideration is measured.

Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

Other highlights

- **Related party compound financial instrument** – Permitted to initially measure the equity component as zero.
- **Related party financial assets** – Assess, and recognize in net income, any impairment of a RP financial asset, before forgiveness of such asset is recognized.
- **All modifications of related party deb**t – are treated as extinguishments of the original financial liability and the recognition of a new financial liability.
- **Disclosure of significant risks arising from derivatives** – is permitted to be included with risks arising from other financial instruments.

Amendments are effective for fiscal years beginning on or after January 1, 2020, applicable retrospectively, with simplified transitional provisions.

Exposure Draft

Accounting for related party financial instruments and significant risk disclosures (cont'd)

Key considerations

- Do you enter into significant related party transactions?
- If so, does the consideration exchanged include financial instruments (e.g. common shares, notes, debt, etc.)?
- Read the final amendments … including the transitional provisions for relief available on adoption!

Agriculture exposure draft

Agriculture – Exposure draft

Objective:

- To address the diversity in practice regarding the accounting for biological assets (i.e., living plants and animals) by agricultural producers.

Timeline:

- **2012 –** Project commenced
- **2015 –** Discussion Paper
- **2017 –** Formation of Agriculture Advisory Group
- **2018 – Exposure Draft**
- **2019 –** Final standard expected
- **2021 –** Proposed effective date

Agriculture – Exposure draft (cont'd)

Scope

Out of scope

Biological Assets	Harvested products	Assets that results from secondary production
Sheep	Wool	Yarn, carpet
Wheat	Harvested wheat	Flour
Dairy cattle	Milk	Cheese
Sow	Weaner	Sausages, cured hams
Sturgeon	Roe	Caviar
Grape vines	Picked grapes	Wine
Fruit trees	Picked fruit	Jam
Beef cattle	Carcass	Ground beef

Biological assets and harvested products are classified based on their nature and use to the enterprise … as **productive biological assets** or **agricultural inventory.**

Agriculture – Exposure draft (cont'd)
Classification and measurement

Productive Biological Assets

Similar to Section 3061 Property, plant and equipment

Measurement – No policy choices

Cost less accumulated depreciation and impairment losses if any.

Agricultural inventories

Similar to Section 3031 Inventories

Measurement – Accounting policy choice

Cost model

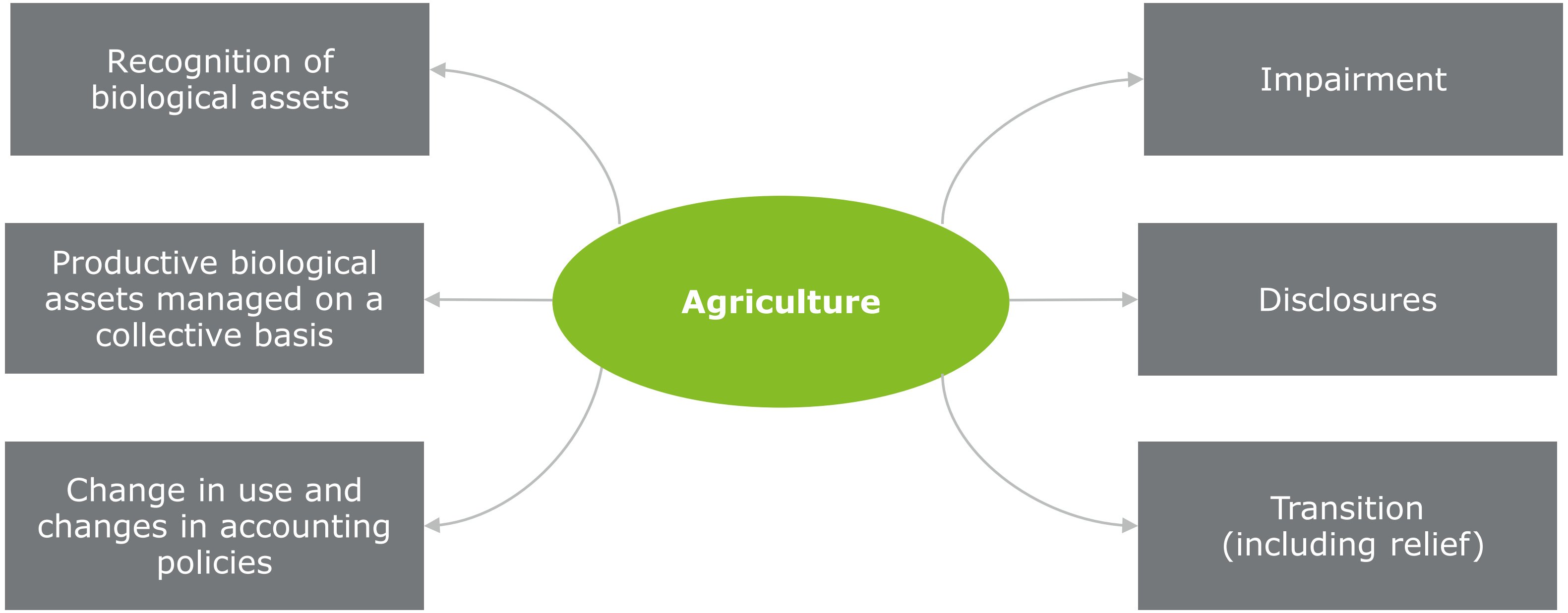
- **Full cost**
- **Only input cost**

NRV model

only if **certain conditions** are met

Agriculture – Exposure draft (cont'd)

Other items



For additional information, please refer to Agriculture Project on the Financial Reporting and Assurance Standards Canada website: http://www.frascanada.ca/standards-for-private-enterprises/projects/active/item55805.aspx

ASPE Resources

Provider	Content	URL
Deloitte Canada's Center for Financial Reporting	News, publications, project updates, summary of standards, and resources	http://www.iasplus.com/en-ca
Financial Reporting and Assurance Standards Canada	Documents for comment, effective dates for new standards, status of active projects	http://www.frascanada.ca/standards-for-private-enterprises/index.aspx
PEAC meetings	Summary of meetings of the Private Enterprise Advisory Committee	http://www.frascanada.ca/standards-for-private-enterprises/private-enterprise-advisory-committee/meeting-notes/item72805.aspx
CPA Canada	Resources including financial reporting, audit issues and much more	https://www.cpacanada.ca/en/business-and-accounting-resources
	ASPE webinars and podcasts featuring: • Amendments to Section 3856, Financial Instruments • AcSB Domestic Standards Update • Exposure draft on Agriculture	https://www.cpacanada.ca/en/career-and-professional-development/webinars/core-areas/financial-and-non-financial-reporting/aspe New!
	ASPE materials including: • ASPE Summary Resource Guide • Amalgamations of Wholly-Owned Subsidiaries • Summary Comparison of ASPE and IFRS	https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/accounting-standards-for-private-enterprises-aspe

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Webcast	Content
Part 1. ASPE updates	A. January 1, 2018 amendments: Cost method and annual improvements B. AcSB updates, including: • Section 3856 amendments (shares issued in a tax planning arrangement and related party financial instruments) • Agriculture Exposure Draft
Part 2. Not-for-profit organizations	New sections for tangible capital assets, intangible assets, and collections
Part 3. Assurance update	The new auditor report
Part 4. Income tax update	Tax planning for year end
Part 5. Data analytics & visualization	Begin your transformation
Part 6. Digitization of the controllership function	How to raise your game for disruptive changes ahead