Private Enterprises, NFPO and Pension Plans

May 2014

Flash

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. International Financial Reporting Standards (IFRS) are not covered by the *Flash* bulletins, but we issue *IFRS Newsletters,* dedicated exclusively to new IFRS developments, and *Adviser Alerts* on specific topics of importance.

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.

Private enterprises (Part II)

2014 Improvements to Accounting Standards for Private Enterprises

In March 2014, the Canadian Accounting Standards Board (AcSB) issued an Exposure Draft entitled *2014 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*.

The final amendments will most likely be issued in the fourth quarter of 2014 and would be effective for years beginning on or after January 1, 2015. Earlier application would be permitted.

The following paragraphs provide a summary of the amendments proposed in the Exposure Draft.

Section 3462, Employee Future Benefits

Section 3462 would be amended to clarify that the option to use a funding valuation for unfunded defined benefit plans can only be applied by entities that have at least one funded defined benefit plan.

Section 3856, Financial Instruments

The AcSB proposes to amend Section 3856 to specify:

- how to account for the hedging item in the hedge of an anticipated transaction when the hedging item matures after the anticipated transaction is recognized and a reporting period ends between the date the hedged transaction occurs and the date the hedging item matures; and

- that for certain financial assets, such as accounts receivable, whose impairment is assessed on a group basis, only the amount of the related allowance for impairment is required to be disclosed and not the carrying amount of the impaired assets.

Future Amendments to ASPE

The AcSB is continuing with various amendment projects to ASPE in order to preserve the quality and credibility of private enterprises' financial statements.

The following is a summary of the projects for which the AcSB plans to issue a Discussion Paper or an Exposure Draft by the end of 2014:

Current projects	Summary
Agriculture	This project addresses accounting for biological assets. A Discussion Paper is expected in the third quarter of 2014.
Redeemable preferred shares issued in a tax planning arrangement	This project plans to re-examine the accounting requirements for redeemable preferred shares issued in a tax planning arrangement in Section 3856. Issues to be discussed include scope, reclassification and measurement. During its March 2014 meeting, the AcSB agreed that redeemable shares should be classified as a liability and requested further analysis of presentation issues associated with these shares. An Exposure Draft is expected in the third quarter of 2014.
Subsidiaries	This project plans to clarify certain issues in accounting for investments in subsidiaries under the cost method and the equity method. One of the areas that will be considered is whether the requirements of Section 1582, Business Combinations, should be applied when an entity accounts for an investment in a subsidiary using either the cost or the equity method. An Exposure Draft is expected in the third quarter of 2014.

Consolidations, Joint Arrangements and Investments

In August 2013, the AcSB published two Exposure Drafts, entitled *Consolidations* and *Joint Arrangements and Investments,* a summary of which is provided in the December 2013 *Flash* bulletin. In March 2014, the AcSB approved the issuance of Sections 1591, Subsidiaries and 3056, Joint Arrangements, as well as amendments to Section 3051, Investments. Section 1591 will replace Section 1590, Subsidiaries, and Accounting Guideline 15 (AcG-15), Consolidation of Variable Interest Entities, while Section 3056 will replace Section 3055, Interests in Joint Ventures. The final versions of the new standards are expected to be released into the *CPA Canada Handbook* in the third quarter of 2014 and are expected to be effective for fiscal years beginning on or after January 1, 2016. Earlier application would be permitted.

Some significant amendments that will be made to ASPE with respect to these projects are summarized as follows:

- Section 1591 would provide guidance to determine whether an enterprise controls another entity through mechanisms other than voting rights associated with a majority shareholding.

- Under Section 3056, the definitions of jointly controlled operations, jointly controlled assets and jointly controlled enterprises would remain unchanged; however, the accounting policy options available would be amended as follows:

  - *Jointly controlled assets and operations*
    The method of accounting for jointly controlled assets and operations would be similar to the proportionate consolidation method currently used under Section 3055 except that the proportion of the assets, liabilities, revenues and expenses to be recognized would be based on relevant facts and circumstances in the contractual arrangement and not solely on the investor's percentage ownership.

  - *Jointly controlled enterprises*
    Investors would have three accounting policy choices to account for interests in jointly controlled enterprises:

    1. Account for all interests using the equity method;

    2. Account for all interests using the cost method; or

    3. Undertake an analysis of these interests to determine if the interests represent an interest in individual assets and liabilities or an interest in the net assets of the joint arrangement. If the investor determines that the interests represent interests in individual assets and liabilities, the investor would be required to recognize its share of those assets and liabilities and of the revenue and expenses. Alternatively, for those interests determined to represent interests in the net assets of a jointly controlled enterprise, the

investor would be required to account for its interests using the equity method.

Some of these projects could also affect the financial statements of NFPO that apply Part III; therefore, these organizations should keep abreast of the proposed amendments.

For more information on ASPE amendments, go to the Financial Reporting & Assurance Standards Canada website.

Private Enterprise Advisory Committee

The Private Enterprise Advisory Committee (the "Committee") was established by the AcSB to assist the AcSB in maintaining and improving ASPE and advise when non-authoritative guidance is needed with respect to the standards. The Committee's most recent meetings were held on December 10, 2013, February 24, 2014 and April 3, 2014. The following paragraphs summarize certain topics discussed at these meetings that have not been discussed elsewhere in this edition of the *Flash* bulletin.

Redeemable Preferred Shares Issued in a Tax Planning Arrangement

In April 2014, the Committee discussed presentation requirements related to the recognition of redeemable preferred shares issued in a tax planning arrangement as a liability, a decision made by the AcSB in its March 2014 meeting. The liability would be measured at fair value on initial recognition. The Committee recommended to the AcSB that the resulting debit be presented as a separate component of equity that would be reclassified to retained earnings as the preferred shares are redeemed. The Committee also recommended disclosure of a description of the transaction that resulted in the separate component of equity. In May 2014, the AcSB tentatively approved the committee's recommendations.

Review of U.S. GAAP for Private Company Amendments

The Committee reviewed the recent updates to United States generally accepted accounting principles (U. S. GAAP) for private companies issued by the U.S. Financial Accounting Standards Board. The Committee agreed to recommend that the AcSB undertake a project to consider possible changes to the current accounting for goodwill. According to the new requirements under U.S. GAAP, private companies have the option to amortize goodwill on a straight-line basis over a maximum period of 10 years.

2014 Annual Improvements

The Committee discussed various items for inclusion in the 2014 annual improvements project. The items discussed that were included in the Exposure Draft are summarized in the first article in this edition of the *Flash* bulletin. The items that were not included are summarized below:

- Financial Instruments — Use of the Fair Value Election Option
  Questions have been raised as to whether the fair value election option in Section 3856 can be used for the subsequent measurement of financial instruments that were initially measured in accordance with Section 3840, Related Party

Transactions. The Committee agreed that the fair value option can only be applied if the financial instrument is initially measured at fair value.

- Related Party Transactions — The Interaction of Sections 1582 and 3840
  Section 3840 requires the accounting for a business transferred between two enterprises under common control to be in accordance with Section 1582 when the transfer must be accounted for and measured at the exchange amount. The Committee noted that the interaction of Sections 1582 and 3840 is not always clear, and requested additional research on the matter. The Committee will continue its discussions on this topic at a subsequent meeting.

- Taxes Payable Method
  The Committee discussed two issues related to the application of the taxes payable method in Section 3465, Income Taxes:

  – The first issue deals with the impact this method has on the accounting for a business combination in accordance with Section 1582. Section 1582 requires the fair value of an acquired item to reflect its tax base when using the taxes payable method. The Committee noted that a fair value calculation would take into account the timing of when temporary differences can be claimed. The Committee agreed that professional judgment should result in appropriate accounting. The Committee also noted that depending on whether the acquirer applies the taxes payable method or the future income taxes method to account for income taxes, the amount of goodwill recognized would be different simply because the fair values of assets recognized in an acquisition are different depending on the tax method used. This is considered to be an acceptable consequence of goodwill being a residual amount.

  – The second issue related to how an entity accounts for the purchase of tax losses that is not part of a business combination when using the taxes payable method rather than the future income taxes method. The Committee noted that the acquisition of tax losses falls within the scope of Section 3465 and that the taxes payable method precludes recognition of an asset related to future income tax recoveries.

- Employee Future Benefits
  The Committee discussed various application issues when an entity uses an actuarial valuation for funding purposes to measure the obligation for a defined benefit plan in accordance with Section 3462.

  – An entity may elect to measure its defined benefit obligation using a funding valuation for its defined benefit plans at the end of the year in which Section 3462 is adopted but it may not have a funding valuation for the comparative period presented. The Committee agreed that a "roll-back" of the funding valuation would be consistent with the "roll-forward" technique in

Section 3462 as well as with the transitional provisions that implicitly use a "roll-back."

– If a funding valuation is used to measure a defined benefit obligation, Section 3462 requires that "the most recently completed" valuation be used. The Committee discussed the significance of these terms and noted that the "Background Information and Basis for Conclusions" document for Section 3462 discusses the AcSB's rationale in this regard. The AcSB did not intend that entities delay issuing financial statements to wait for a valuation report or accelerate their process of obtaining a funding valuation. Entities would use the most recent actuarial valuation at their disposal when preparing their financial statements.

For more information on the Committee, go to the Financial Reporting & Assurance Standards Canada website.

Not-for-profit Organizations (Part III)

Many of the topics covered in section "Private Enterprises (Part II)" may also be relevant for NFPO that apply Part III of the *CPA Canada Handbook*.

Since the publication of the December 2013 *Flash* bulletin, no significant standard-setting activities were undertaken in Canada with regards to NFPO accounting.

In 2013, the AcSB and the Public Sector Accounting Board issued a Statement of Principles entitled *Improvements to Not-for-Profit Standards* proposing to improve accounting standards for NFPO in the private and public sectors that currently apply either Part III of the *CPA Canada Handbook* or the *CPA Canada Public Sector Accounting Handbook* (including the PS 4200 series of sections). The topics of discussion in the Statement of Principles are:

- contributions;
- tangible capital assets;
- intangibles assets;
- exemption from tangible and intangible capital assets recognition for smaller NFPO;
- works of art, historical treasures and similar items;
- controlled and related entities; and
- financial statement presentation.

In March 2014, the AcSB were presented with a summary of the comments received regarding the Statement of Principles and, in May 2014, the AcSB began deliberating these comments.

For more information on the Statement of Principles, refer to the August 2013 *Flash* bulletin.

Pension Plans (Part IV)

Since the publication of the December 2013 *Flash* bulletin, no standard-setting activities were undertaken in Canada with regards to pension plan accounting.