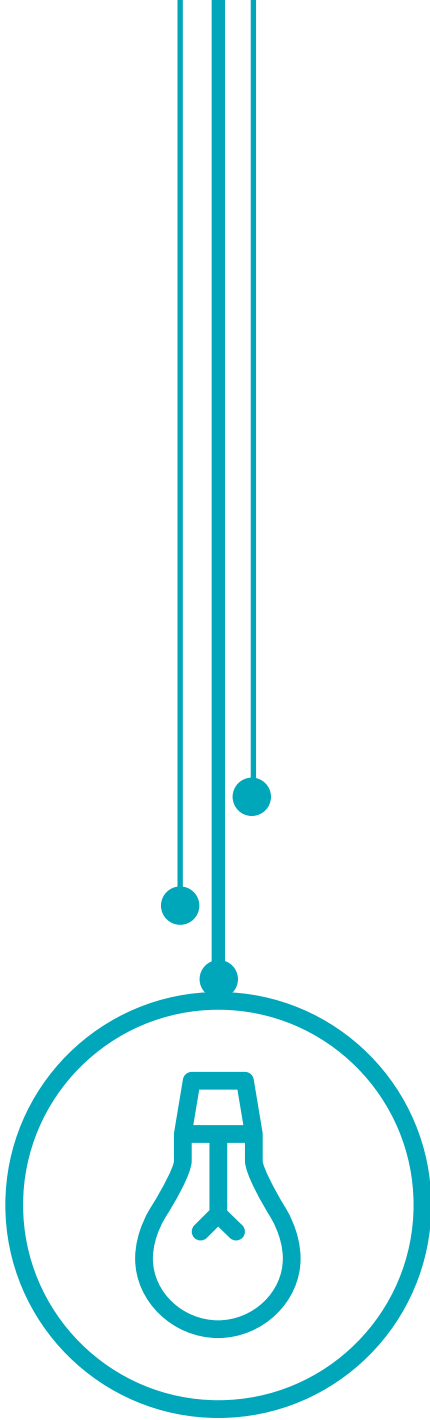




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I like progress but I hate change.

Jon Bon Jovi

With each new smart phone and each new app that hits the market, we get excited about all the potential benefits, but recognize that with each new innovation comes a period of adjustment. Ultimately, we adapt to the new technology, learn to do things differently and we progress.

That is what's happening with Accounting standards for private enterprises ("ASPE"). The core principles of ASPE have not changed. However, as private company transactions have become more complex and user expectations have changed, certain of the ASPE standards needed to change in order to progress.

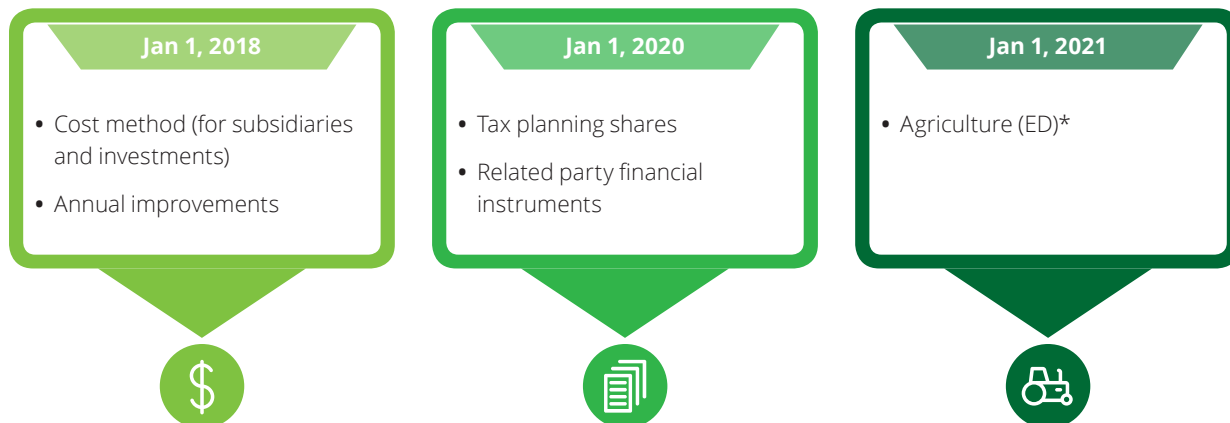
In this publication, we will review some of the key changes to ASPE that will impact private companies in 2018, as well as some important changes to the ASPE standards that are coming down the road.

We hope you find this publication helpful in keeping up to speed on key developments in ASPE. Remember also that to stay on top of developments in ASPE on a regular basis, you can visit Deloitte's Centre for Financial Reporting, which includes news and resources dedicated to meeting your ASPE financial reporting needs.



What's changed at a glance?

The key changes to ASPE and their effective dates are summarized below:



**ED refers to a proposed change to ASPE that is still in the Exposure Draft stage. Accordingly, the proposed standard and the effective date are tentative.*



Changes effective in 2018

There are two main changes to ASPE that are effective for fiscal years beginning on or after January 1, 2018:

1. changes to the cost method and
2. annual improvements.

1. The cost method – new and improved!

Currently, companies have a policy choice to account for their subsidiaries, investments subject to significant influence and interests in jointly controlled enterprises using the cost method. Despite the fact that the cost method has been around for many years, there has been relatively little guidance on how it should be applied and this has led to some diversity in practice. As a result, amendments were made to address this.

The amendments do not change the fundamentals of the cost method – investments are still initially recognized at cost, and earnings from such investments are only recognized to the extent received or receivable. The most significant change is that an interest in a subsidiary will be initially measured on a basis that is similar to other business combinations, with certain simplifications. This is likely to result in companies applying more rigor when analyzing the acquisition of a new subsidiary.

New guidance has also been added to Section 3051, *Investments*, on how to apply the cost method to investments subject to significant influence. Based on the scope of Section 3051 and a recently issued Exposure Draft, it appears reasonable that the amendments to the cost method in Section 3051 also apply to interests in jointly controlled enterprises, when they are accounted for using the cost method.

The table below summarizes the key requirements of the new cost method when

accounting for subsidiaries (see “Section 1591” column) and investments subject to significant influence and interests in jointly controlled enterprises (see “Section 3051” column):

	Subsidiaries Section 1591	Investments Section 3051
Initial measurement		
• Cost is measured at the acquisition-date fair value of the consideration transferred to the other party in exchange for the investment.	●	●
• Acquisition-related costs are expensed, except for the costs to issue debt or equity.	●	●
• Costs to settle pre-existing relationships with the subsidiary, or arrangements entered into during negotiations that are separate from the acquisition of the subsidiary (e.g., remuneration of former owners of the acquiree for future services), are not included in the cost of the investment.	●	
• In a step acquisition , the previously held interest is not re-measured.	●	●
• A bargain purchase gain is not recognized.	●	
• Provisional amounts are used to measure the interest in the subsidiary when the initial accounting is not complete (such as when there is a working capital adjustment clause).	●	
• Transfers of subsidiaries between entities under common control are accounted for at their carrying amount (unless specific conditions are met).	●	
Subsequent measurement		
• Earnings from subsidiaries or investments are recognized only to the extent received or receivable.	●	●
• Contingent consideration is re-measured when the contingency is resolved on the same basis as is required by Section 1582, <i>Business Combinations</i> .	●	
• Provisional amounts must be finalized within the “measurement period”, with no restatement of prior periods.	●	
• Purchases of additional interests and sales of portions of interests in subsidiaries do not result in a re-measurement of the existing interest or retained interest to fair value.	●	
• New impairment indicators exist such as when an investor purchases an additional interest or sells a portion of an interest in an investment for a price which is less than its proportionate carrying amount. An investor should assess its investments for any indicators of impairment at each reporting period end.	●	●

The amendments to the cost method are applicable **prospectively** for fiscal years beginning on or after January 1, 2018. Therefore, the amendments will not impact acquisitions made in prior periods, but will impact new acquisitions, or changes in ownership interests, made after the effective date.



What to watch out for when acquiring a new subsidiary?

When a business is acquired, the acquirer may agree to make additional payments to selling shareholders based on the performance of the business (e.g., payments are made if the business exceeds a certain EBITDA threshold). At first glance, these payments might appear to be contingent consideration. However, this is not always the case, particularly when the selling shareholders agree to provide services to the business. Careful

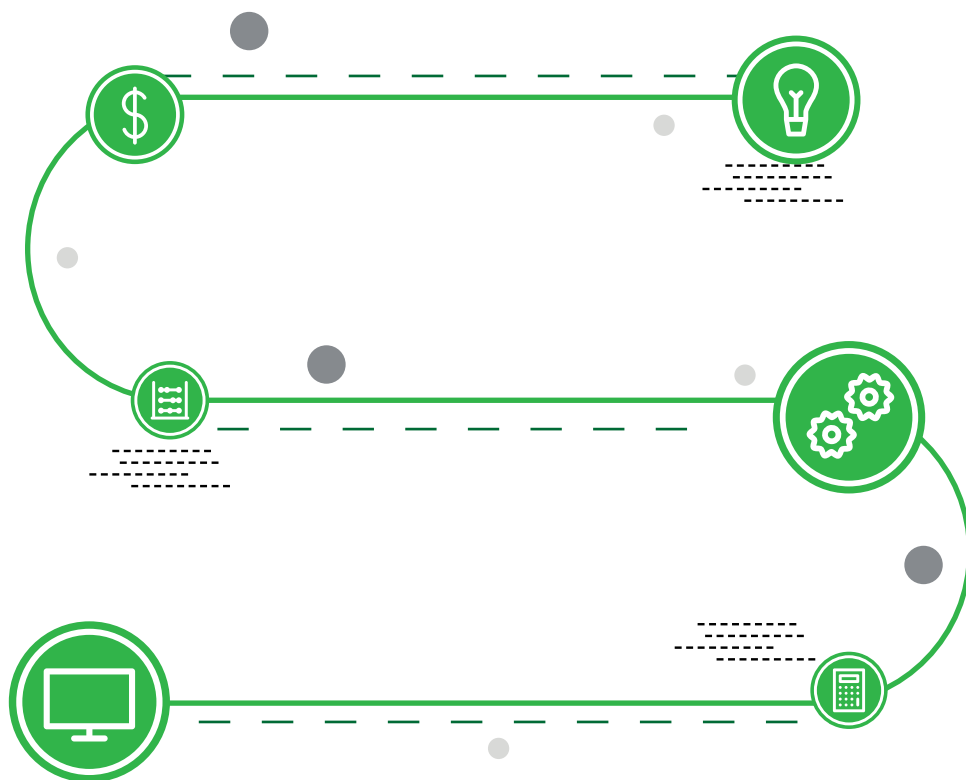
analysis will be required to determine if the payments represent contingent consideration (i.e., purchase consideration) or compensation for future services (i.e., expense in the post-acquisition period). If you are entering into an acquisition where there are contingent payments, it is important to consider all of the facts and guidance in Section 1582 on “arrangements for contingent payments to employees and selling shareholders” when evaluating the nature of such payments.

2. Annual Improvements

Annual improvements are made to ASPE to clarify wording, or correct for relatively minor unintended consequences, oversights or conflicts. The 2017 annual improvements to ASPE are summarized below:

Annual Improvement	Observation
1. Accounting policies are now required to be disclosed as “one of the first notes” to the financial statements rather than as the “first note”.	<i>This will provide greater flexibility in allowing certain notes to be presented first e.g., nature of the business, a significant doubt about the entity's ability to continue as a going concern.</i>
2. When there is a change in accounting policy, the line-by-line impact is now required to be disclosed “for each prior period presented”. Companies are no longer required to disclose the impact on the current period.	<i>This is expected to provide more useful information to users.</i>
3. A clarification has been made as to which items are required to be presented on the face of the balance sheet versus disclosed in the notes to the financial statements.	<i>While the changes are not expected to be significant, companies are encouraged to review their current balance sheet presentation.</i>
4. An amendment has been made which requires inventory write-downs in the translated financial statements of an integrated foreign operation to be reversed, when certain conditions are met.	<i>Companies affected should consider the impact on processes and controls for identifying reversals of inventory write-downs including reversals caused by a favorable movement in the exchange rate.</i>
5. For impaired operating lease receivables, the amendments clarify that a lessor is only required to disclose the amount of the allowance for impairment and not the carrying amount of impaired operating lease receivables.	<i>This will simplify the disclosure for lessors.</i>

These annual improvements are effective for fiscal years beginning on or after January 1, 2018. Companies affected by these improvements are encouraged to read the amendments, in full, to assess the impact on their financial statements.



Changes effective in 2020

In December, 2018, the Canadian Accounting Standards Board (“the Board”) released two prominent sets of amendments to Section 3856, *Financial Instruments*, dealing with:

1. Retractable or mandatorily redeemable shares issued in a tax planning arrangement (i.e., tax planning shares)

What are the key changes?

Companies which issue redeemable preferred shares in a tax planning arrangement under certain specified sections of the Income Tax Act are currently exempt from classifying these shares as liabilities, pursuant to paragraph 23 of Section 3856, *Financial Instruments*. Due to concerns that the exception was being applied more broadly than originally intended, the Board has withdrawn the exception and replaced it with a new model which is premised on the notion that equity classification is permitted for retractable or mandatorily redeemable shares issued in a tax planning arrangement only if “nothing of substance has changed”.

Under the new model:

Retractable or mandatorily redeemable shares issued in a tax planning arrangement are classified as **equity** only if all of the following conditions are met:

1. Control of the enterprise is retained by the shareholder receiving the shares
2. Only shares are exchanged (or no consideration is received by the issuing enterprise) AND
3. No other written or oral arrangement exists, such as a redemption schedule, that gives the holder the contractual right to require the enterprise to redeem the shares on a fixed or determinable date (or within a fixed or determinable period)

Retractable or mandatorily redeemable shares issued in a tax planning arrangement; and

Financial instruments in a related party transaction

If all three conditions **are met**, the shares would be classified as equity and measured at their par, stated or assigned value (which is generally nominal). The shares need to be monitored for any events or changes in circumstances which indicate that one or more of the conditions are no longer met. When the conditions are no longer met, the shares are reclassified as financial liabilities.

If any of the three conditions is **not met**, the shares would be classified as financial liabilities and measured at their redemption amount (i.e., amount due on demand), with an offsetting charge recorded to a separate component of equity or retained earnings. Shares initially classified as a financial liability are prohibited from being reclassified to equity, even if circumstances change.

Entities also have **an option** to present the shares as a financial liability, thereby avoiding the cost of analyzing the three conditions.

Which transactions will not qualify for equity classification under the new model?

1. Asset rollover transactions will not qualify for equity classification.

When an individual transfers an asset, such as a building, to an enterprise in a tax planning arrangement in exchange for mandatorily redeemable shares, the introduction of the new asset will cause the cash flows of that enterprise to change as opposed to “freezing” its value. The mandatorily redeemable shares issued by the enterprise would not qualify for equity treatment as the condition requiring the transaction involve “an exchange of shares only” is not met. However, there is relief for asset rollovers on transition.

2. Estate freeze transactions that meet the three conditions are expected to qualify for equity classification.

However, not all estate freeze transactions are expected to qualify. For example, several shareholders which **jointly control** an enterprise undertake an estate freeze in which

they exchange their common shares for mandatorily redeemable shares, after which they each continue to jointly control the enterprise. The mandatorily redeemable shares would not qualify for equity classification, as the control condition is not met: none of the shareholders individually controlled the enterprise either before or after the transaction. Therefore, the retractable or mandatorily redeemable shares would be classified as financial liabilities.

3. Shares issued to related parties? If retractable or mandatorily shares are issued to two or more related parties, the enterprise must determine which of the related parties has control. For example, two spouses each receive 50% of the mandatorily redeemable shares issued by an enterprise in a tax planning arrangement. If one spouse has control of the enterprise before and after the transaction, the mandatorily redeemable shares issued to that spouse would be classified as equity (provided the other two conditions are met), and the shares issued to the other spouse would be classified as a financial liability. Therefore, for purposes of the model, two spouses cannot consider themselves a “single unit” when assessing control.

When are the amendments effective?

The amendments are effective for fiscal years beginning on or after January 1, 2020, and are applicable retrospectively with transitional relief. Enterprises will need to assess whether outstanding retractable or mandatorily redeemable shares issued in a tax planning arrangement meet the conditions for equity classification on transition.

For retractable or mandatorily redeemable shares issued **before** January 1, 2018, an enterprise is only required to meet the first and third conditions to qualify for equity on transition (i.e., is not required to meet the exchange of shares only condition). This will result in shares issued in asset rollovers before January 1, 2018 to qualify

for equity classification on transition. For retractable or mandatorily redeemable shares issued **on or after** January 1, 2018, all three conditions must be met to qualify for equity classification.

For companies which determine that their retractable or mandatorily redeemable shares issued in a tax planning arrangement **do not** qualify for equity classification on transition:

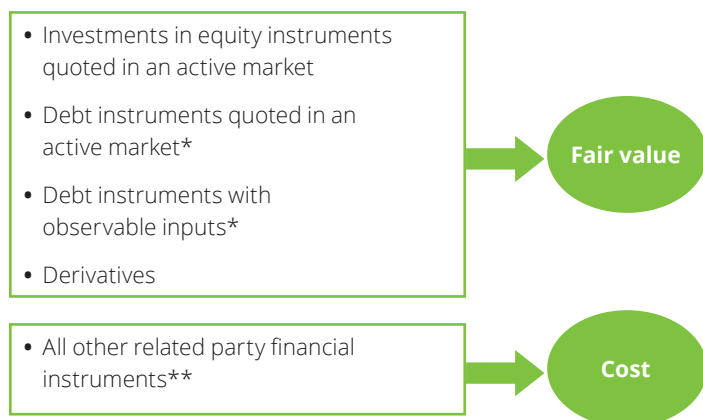
- The shares will need to be re-classified from equity to liabilities and measured at their redemption amount. The shares would need to be classified as current (as they are due on demand).
- The reclassification of the shares may adversely impact financial ratios, such as the current ratio and debt to equity ratio, which may require renegotiation of banking covenants going forward.
- For companies which apply the future income taxes method, consideration would need to be given to the impact on future income taxes.

2 Financial instruments in a related party transaction

Section 3856, *Financial Instruments*, has been amended to clarify the accounting for financial instruments in a related party transaction.

What are the amendments in a nutshell?

Financial instruments in a related party transaction are measured, on initial recognition, as follows:



*for subsequent measurement, accounting policy choice: fair value or amortized cost.

** for subsequent measurement, cost less impairment.

The **cost** of a financial instrument in a related party transaction will depend on whether the instrument has repayment terms. When the financial instrument has repayment terms, such as a loan receivable or payable, the cost is determined using the undiscounted cash flows of the instrument (excluding interest and dividends). When the financial instrument does not have repayment terms, such as common shares, the cost of the instrument is determined using the consideration transferred or received by the enterprise in the transaction.

These amendments are expected to simplify the accounting for related party loans considerably, by confining the circumstances when fair value measurements are required.

In addition, the amendments provide the following clarifications:

- All modifications of financial liabilities between related parties are accounted for as extinguishments (eliminating the need to perform the “10% test”).
- Enterprises should first assess for, and recognize in net income, any impairment of a related party financial asset before recognizing any subsequent forgiveness of the asset. Such forgiveness is recognized in net income or equity, depending on the nature of the original transaction that gave rise to the asset.
- For related party compound financial instruments, the equity component can be initially measured at “zero”.
- Entities should disclose enterprise-specific information about an entity's current exposure from financial instruments (e.g., significant foreign currency denominated debt).

The amendments are applicable retrospectively for fiscal years beginning on or after January 1, 2020, with simplified transitional provisions. Companies which undertake significant related party transactions are expected to benefit from the simplifications provided.



Agriculture: Exposure Draft

In 2018, the Accounting Standards Board published its Exposure Draft, *Agriculture*, which provides long-awaited guidance on the accounting for agricultural inventories and productive biological assets. The guidance is expected to impact companies operating in various agricultural sectors ranging from cannabis to cattle ranching to vineyards.

Under the proposals, agricultural inventories are viewed as being akin to conventional inventories, and a policy choice is provided to measure agricultural inventories using a cost model or a net realizable value model (only if certain conditions are met). Productive biological assets are viewed as

being akin to property, plant and equipment and will be generally recognized at cost less amortization and impairment losses. The Exposure Draft provides detailed application guidance on the classification of assets, the cost and net realizable value models, changes in use, impairment and disclosure.

Based on the proposals, a new accounting standard for agriculture is expected to be effective for fiscal years beginning on or after January 1, 2021, and applicable on a retrospective basis. Agricultural producers who will be impacted by the proposed guidance are encouraged to monitor this project closely.



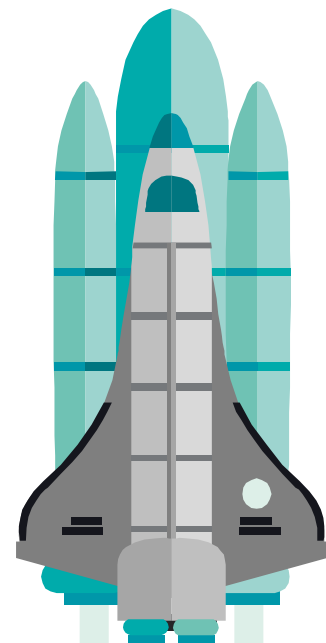
In other news...

Two Exposure Drafts were released in 2018 – one proposing to clarify that the amendments to the cost method in Section 3051, *Investments*, also apply to interests in jointly controlled enterprises, and a second proposing to eliminate the requirement in Section 3465, *Income Taxes*, to classify future income taxes into current and non-current portions.

There is also a project on *Revenue* underway that proposes to add guidance to Section 3400, *Revenue*, in areas where guidance is currently lacking, such as: bill-and-hold arrangements, multiple element arrangements, percentage-of-completion, gross versus net, and upfront non-refundable fees. An Exposure Draft for Revenue is expected to be issued in the second half of 2019.

Final thoughts

As you can see there have been some relatively significant changes to ASPE in the current year and some potentially more significant changes that will become effective in the near term. As you work through the implications of these to your business, we encourage you to reach out to your Deloitte professional advisor with any questions.



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