CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Financial Reporting Alert

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

JULY 2019

CHANGE TO EFFECTIVE DATE OF SECTION 3051, *INVESTMENTS* AND SECTION 3465, *INCOME TAXES*

In June 2019, Section 3051, *Investments* and Section 3465, *Income Taxes* were amended in the *CPA Canada Handbook – Accounting*, with the amendments effective for years beginning on or after January 1, 2020. As a result of the COVID-19 health pandemic, the Accounting Standards Board is deferring the effective date of the amendments to these sections by one year to be effective for years beginning on or after January 1, 2021. Early application is permitted. Further details on this and decisions related to other amendments to the *CPA Canada Handbook – Accounting* can be found in the Accounting Standards Board April 15, 2020 Decision Summary.

Amendments to Investments and Income Taxes

In June 2019, the Accounting Standards Board (AcSB) issued amendments to Section 3051, *Investments* and Section 3465, *Income Taxes* (*Amendments*) of Part II (Accounting Standards for Private Enterprises) of the *CPA Canada Handbook – Accounting* (*Handbook*). This *CPA Canada Financial Reporting Alert* (*Alert*) highlights key changes resulting from the *Amendments* and considers some possible assurance implications.

What are the main objectives of the *Amendments*?

The main objectives of the *Amendments* are to:

- clarify that the guidance added to Section 3051 in December 2016 on how to apply the cost method to an investment subject to significant influence also applies to an interest in a jointly controlled enterprise accounted for using the cost method
- remove an outdated illustrative example from Section 3465
- enhance the presentation and disclosure requirements of Section 3465 when an entity uses the future income taxes method.

Who applies the *Amendments*?

The principal users of the *Amendments* will be private enterprises applying Part II of the *Handbook*. The *Amendments* also apply to non-government-controlled not-for-profit organizations (NFPOs) applying Part III (Accounting Standards for Not-for-Profit Organizations) of the *Handbook*.[1]

When are the *Amendments* effective?

The *Amendments* are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2020. Earlier application is permitted.

What are the key changes?

This *Alert* addresses the key changes as a result of the *Amendments* in four main sections:

A. Application of the Cost Method in Section 3051 to Interests in Jointly Controlled Enterprises
B. Removal of Illustrative Example from Section 3465
C. Changes to Presentation and Disclosure Requirements for Future Income Taxes
D. Transition Provisions

This *Alert* also discusses the possible assurance implications of the *Amendments*.

A. Application of the Cost Method in Section 3051 to Interests in Jointly Controlled Enterprises

In December 2016, guidance was added to Section 3051 on how to apply the cost method to an investment subject to significant influence (see paragraph 3051.07A). Section 3056, *Interests in Joint Arrangements* allows an investor with an interest in a jointly controlled enterprise to account for that interest using either the equity method or the cost method, as defined in Section 3051. Questions had arisen in practice on whether the guidance on application of the cost method in paragraph 3051.07A also applied to interests in jointly

1 NFPOs in the private sector may apply Part III or Part I (International Financial Reporting Standards) of the *Handbook*. A NFPO applying the accounting standards in Part III of the *Handbook* also applies the standards for private enterprises in Part II to the extent the standards in Part II address topics not addressed in Part III.

controlled enterprises. The *Amendments* clarify that the guidance in paragraph 3051.07A does apply to an interest in a jointly controlled enterprise that is accounted for using the cost method.

As amended, paragraph 3051.07A indicates the following with respect to determining the initial measurement of an investment subject to significant influence or an interest in a jointly controlled enterprise accounted for using the equity method:

- The initial cost of an investment is measured at the acquisition-date fair value of the consideration transferred (including both monetary and non-monetary consideration transferred on, before or after the acquisition date) to the other party in exchange for the investment.
- When an investment subject to significant influence or an interest in a jointly controlled enterprise is acquired by the exchange of only equity interests and the acquisition-date fair value of the investee's equity interests is more reliably measurable than the acquisition-date fair value of the enterprise's equity interests, the enterprise determines the fair value of the consideration transferred using the acquisition-date fair value of the investee's equity interests instead of the acquisition-date fair value of the enterprise's equity interests transferred.
- Acquisition-related costs are recognized as expenses in the periods in which the costs are incurred or the services are received. The only exception is for costs incurred to issue debt or equity securities, which are to be recognized in accordance with the guidance in Section 3856, *Financial Instruments* and Section 3610, *Capital Transactions*, respectively, in Part II of the *Handbook*.
- When an investor is able to exercise significant influence or obtains joint control over an investee in which the investor previously held an interest, or acquires an additional interest in such an investee which does not result in control, the cost of the resulting investment is equal to the carrying amount of the investment immediately before the increase in the investor's interest plus the cost of the additional interest acquired, measured as described above. In addition:
  - The previously held interest in the investee is not remeasured.
  - Acquisition-related costs for the previously held interest capitalized in accordance with Section 3856 continue to be included in the carrying amount of the investment in an investee and are not expensed. However, acquisition-related costs on the additional interest are recognized as an expense in accordance with the guidance above.
- The investor is required to assess whether the cost of the additional interest acquired indicates that the carrying amount of the investment in an investee may be impaired.

Key Concept

The same accounting guidance is applicable when the cost method is used to account for an investment subject to significant influence or an interest in a jointly controlled enterprise. The initial cost of an investment is measured at the acquisition-date fair value of the consideration transferred to the other party in exchange for the investment. Acquisition-related costs, with limited exceptions, are expensed in the period the costs are incurred or the services received.

B. Removal of Illustrative Example from Section 3465

The illustrative example in paragraph 3465.14(f) provided guidance on accounting for the tax impacts of eligible capital property (ECP). The ECP rules in Section 14 of the Canadian *Income Tax Act* were repealed and replaced with new Class 14.1 of Schedule II to the Canadian Income Tax regulations, effective January 1, 2017. The illustrative example is therefore no longer relevant and the *Amendments* remove it from Section 3465.

C. Changes to Presentation and Disclosure Requirements for Future Income Taxes

Currently, Section 3465 requires that future income tax assets and liabilities be classified as current and non-current when the future income taxes method is applied. The *Amendments* require all future income tax assets and liabilities to now be classified as non-current irrespective of the timing of the reversal of the temporary differences that create them. Consequential amendments were also made to Section 1510, *Current Assets and Current Liabilities* in Part II of the *Handbook* to remove any references to current classification of future income tax assets and liabilities.

This change simplifies the presentation of future income tax assets and liabilities. It is also consistent with the guidance in International Accounting Standard (IAS) 12, *Income Taxes* in Part I (International Financial Reporting Standards) of the *Handbook*. Also, recent amendments to United States Generally Accepted Accounting Principles do not require the separation of deferred tax assets and liabilities into current and non-current components since feedback indicated that it did not provide useful information to the users of financial statements.

Section 3465 currently does not contain a disclosure requirement to identify the types of temporary future income tax differences. Accordingly, the *Amendments* add a requirement to disclose the amount of future income tax assets and liabilities for each significant type of temporary difference for each period presented.

Key Concept

All future income tax assets and liabilities will now be presented as non-current and the disclosure of the significant components of the future income tax assets and liabilities presented on the balance sheet is now required.

D. Transition Provisions

The *Amendments* to Section 3465 are to be applied retrospectively, as defined in paragraph .05(d) of Section 1506, *Accounting Changes* in Part II of the *Handbook*. However, the *Amendments* to Section 3051 may be applied prospectively as defined in paragraph .05(g) of Section 1506.

What are the possible assurance implications?

The changes discussed in this *Alert* as a result of the *Amendments* may require the auditor and management to discuss:

- the measurement of interests in jointly controlled enterprises where the cost method is used for interests acquired in fiscal years beginning on or after January 1, 2020 (unless the *Amendments* are adopted retrospectively)
- whether the requirement to classify future income tax assets and liabilities as non-current will impact any financial ratios or financial covenants monitored by any of the users of the entity's financial statements
- the identification of the amount of future income tax assets and liabilities for each significant type of temporary difference, and the extent to which these amounts should be disclosed based on the needs of the users of the financial statements.

In addition, the following considerations related to the *Amendments* may be relevant in assurance engagements:

- provision by management of sufficient financial information for any interests in jointly controlled enterprises affected by the *Amendments* to the cost method to appropriately account for the interests, including any assessment for impairment
- provision by management of sufficient financial information necessary to disclose the amount of future income tax assets and liabilities for each significant type of temporary difference for each period presented
- determination of whether the planned procedures are appropriate (e.g., consideration of management's analysis of any investments affected by the *Amendments* to the application of the cost method to interests in jointly controlled enterprises or the separate disclosure of each type of temporary difference for each period presented when identifying a risk of material misstatement (audit) or an area where it is likely a material misstatement will arise (review))
- consideration of the reporting requirements related to retrospective application of the amendments to Section 3465, if any.

What resources are available to help me?

CPA Canada

- **ASPE Alert: Subsidiaries, Investments and Interests in Joint Arrangements**
- **ASNPO Alert: Accounting Standards Applicable to Private Sector Not-for-Profit Organizations**

AcSB

- **AcSB Domestic Standards Update for Part II and Part III**

Comments

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