Assurance and Accounting

Accounting Standards for Private Enterprises (ASPE) Update 2022

Introduction

It was a busy year for the Accounting Standards Board (AcSB or the Board) and for Part II of the CPA Canada Handbook – Accounting: Accounting Standards for Private Enterprises (ASPE). As entities continue to adapt to the ever-changing business and market landscape, the Board was hard at work advancing the progress of various projects, including its projects on cloud computing arrangements and related party contributions.

In addition, several amended and new standards became effective in 2022 including the issuance of new Section 3041, *Agriculture*, and significant amendments to Section 3400, *Revenue*. This publication will discuss these changes, as well as, other amendments and standards effective over the next few years and will provide an overview of the projects the Board has on the go that will affect private sector entities.

Standards Effective in 2022

Significant amendments to Section 3400, Revenue

In 2017, the AcSB issued a survey asking stakeholders for feedback on issues they encountered when applying the guidance in Section 3400, *Revenue*. As a result of the feedback provided, the Board issued amendments to Section 3400 to provide additional guidance on the following complex areas:

- Identifying the units of account – guidance on how to determine whether an arrangement consists of a group of contracts or a single contract and identifying the units of account in an arrangement;
- Bill-and-hold arrangements – guidance on how to determine if revenue can be recognized when the delivery of the goods or services has yet to occur;
- Multiple-element arrangements – guidance on how to allocate consideration to elements in multiple deliverable arrangements using the relative stand-alone selling price basis, as well as, methods to be used for estimating the stand-alone selling price when not directly observable;
- Percentage of completion method – guidance on how to determine the degree of completion and compute the revenue to be recognized in a period, as well as, additional disclosure requirements for contracts in progress at the end of the reporting period; and
- Reporting revenue gross or net - added additional indicators to aid in determining whether revenue should be recognized on a gross or net basis.

These amendments are effective for fiscal years beginning on or after January 1, 2022 and are to be applied retroactively. However, transitional relief has been provided for certain situations, where an enterprise would not be required to make retrospective adjustments for long-term contracts accounted for using the percentage of completion method, or when accounting for multiple element arrangements. For additional information refer to our ASPE at a Glance: Section 3400 – Revenue publication.

As part of the above project, the Board also added additional guidance to Section 3400 on when revenue should be recognized for upfront non-refundable fees/payments. However, as entities started to apply these amendments the Board received feedback from stakeholders, particularly member-benefit organizations, on concerns about the decision-usefulness of deferring upfront non-refundable fees over long membership durations and the costs of applying the amendments. As a result, the Board decided that additional research on these issues was needed. The Board issued an Exposure Draft in July proposing to defer the effective date of the amendments for upfront non-refundable fees/payments to fiscal years beginning on or after January 1, 2025 to give it time to carry out this research. Respondents agreed with the proposals and the Board approved the deferral of the effective date at its September 2022 meeting.

Amendments to Section 3462, Employee Future Benefits

In 2018, Ontario's pension regulator introduced a new reserve, the provision for adverse deviations (PfAD), in the going concern funding valuation for defined benefit plans. This reserve is meant to cover unexpected adverse deviations in such plans. Similarly, in 2016 Quebec enacted Bill 57, which eliminated the requirement to fund a pension plan on a solvency basis. Instead, plans are funded on a going concern basis with a new requirement to establish a reserve called a stabilization provision, the purpose of which is similar to that of the PfAD. Other Provinces have also introduced similar legislation. Stakeholders raised questions on whether the PfAD and the stabilization provision should be included in the measurement of the defined benefit obligation when an entity makes an accounting policy choice to use a funding valuation under Section 3462, *Employee Future Benefits*, as there was diversity in practice.

As a result, the AcSB amended Section 3462 to clarify the accounting as follows:

- When an entity has defined benefit plans without a legislative, regulatory, or contractual requirement to prepare an actuarial valuation for funding purposes, the obligations for these plans are measured using an actuarial valuation prepared for accounting purposes. The previous accounting policy choice to measure such plans on a funding valuation basis has been removed due to the complexities in applying this method and the diversity it caused in practice.
- When an entity has defined benefit plans with a legislative, regulatory or contractual requirement to prepare an actuarial valuation for funding purposes, the obligations for these plans are measured using either an actuarial valuation prepared for accounting purposes or the most recently prepared actuarial valuation prepared for funding purposes provided specific criteria is met.
- When an entity elects to use a funding valuation to measure the defined benefit obligation for defined benefit plans that have a funding valuation requirement:
    - The defined benefit obligation would be measured at the amount that is required to be funded by contributions in accordance with legislative, regulatory, or contractual requirements; and
    - The aggregate of all underlying components of the legislative, regulatory, or contractual requirements would be included in that measurement of the defined benefit obligation (for example the Ontario PfAD and Quebec stabilization provision would be included).

The amendments are effective for fiscal years beginning on or after January 1, 2022 with certain transitional provisions. For additional information refer to our ASPE at a Glance: Section 3462 – Employee Future Benefits publication, as well as, our publication Employee Future Benefits – What you Need to know about Sections 3462 and 3463.

2021 Annual Improvements

The Board has adopted an annual improvement process to amend standards to help clarify guidance/ wording or correct for unintended consequences or conflicts. Any large amendments or the issuance of new standards are outside the scope of this process. During the 2021 annual improvement process the Board made the following amendments:

- Section 1500, *First Time Adoption*, was amended to allow entities that had previously applied ASPE but whose most recent annual financial statements were not reported under ASPE, to either apply Section 1500 again upon re-adoption of ASPE, or to apply the standards retrospectively in accordance with Section 1506, *Accounting Changes*;
- Section 1510, *Current Assets and Current Liabilities*, has been amended to allow entities the option to present amounts owing from directors, officers or shareholders and amounts owing to parents and other affiliated companies in aggregate with the amounts disclosed separately in the notes;
- Section 1540, *Cash Flow Statement*, was amended to remove the need to disclose in aggregate for business combinations and disposals of business units, the total assets and total liabilities acquired or disposed of; and
- An error in Illustrative Example 3 in Section 3856, *Financial Instruments*, was corrected.

The amendments are effective for fiscal years beginning on or after January 1, 2022.

Amendments to Section 3856, Financial Instruments

Canada and many jurisdictions across the globe have taken recommendations from the Financial Stability Board's (FSB) report on Reforming Major Interest Rate Benchmarks and are replacing the existing Interbank Offered Rates (IBORs) (for example, the London interbank offered rate (LIBOR), and the Canadian dollar offered rate (CDOR)) with alternative benchmark rates (IBOR reform). As a result of this transition, many debt and derivative contracts that reference these rates will be modified. Section 3856, *Financial Instruments*, requires entities to perform qualitative and quantitative assessments, such as the 10% test, to determine if modifications should be accounted for as extinguishments. For entities with numerous instruments that reference IBOR, this could be very onerous. Also, under Section 3856 a change in the benchmark rate for derivative contracts designated in a hedging relationship would lead to the discontinuation of hedge accounting. These outcomes would not provide financial statements users with useful information.

The Board understood these concerns and issued amendments to Section 3856 to simplify the accounting analysis for debt modifications solely due to IBOR reform, as well as, to allow hedge accounting to continue where there is a change in certain critical terms related to IBOR reform. The main points of the amendments are outlined below:

- Debt Modifications: Entities are given the option to apply a practical expedient to not account for a modification made to one or more contractual terms in an arm's-length debt instrument due to IBOR Reform as an extinguishment, but instead to account for the modification as a continuation of the existing debt instrument. If the practical expedient is applied, it must be applied to all debt instruments that reference IBOR.
- Hedge Accounting: Exceptions to the hedge accounting guidance would apply where critical terms have changed as a direct result of IBOR Reform and as a result the hedging relationship would not be discontinued. The exception would cease being applied once all changes related to the IBOR reform have been made to the hedging and hedged items. The exception would apply to only the following hedging relationships where critical terms are expected to be modified due to IBOR reform:
  - An interest-bearing asset or liability hedged with an interest rate swap to mitigate the effect of changes in interest rates; and
  - A foreign currency denominated interest-bearing asset or liability hedged with a cross-currency interest rate swap to mitigate the effect of changes in interest rates and foreign currency exchange rates.

The amendments are effective for fiscal years ending on or after February 1, 2022, and are applied retrospectively, except for certain situations as outlined in Section 3856. Some additional disclosures are required.

New Section 3041, Agriculture

The agriculture industry is a significant industry in Canada. However, due to a lack of guidance addressing the unique aspects of accounting for agriculture there was diversity in practice, specifically around the measurement of biological assets and agricultural inventories. As a result, the Board consulted with stakeholders and issued new Section 3041, *Agriculture*. Highlights of the new standard include:

Scope

- Section 3041 applies to an agricultural producer's agricultural inventories and productive biological assets, including transactions related to agricultural production such as the purchase of the harvested products of biological assets for use in agricultural production.
- It does not apply to forestry, harvesting from sources that are not owned or controlled by the agricultural producer, the raising or purchasing of animals for competitive sport, or agricultural inventories held by enterprises that are not agricultural producers. It also does not apply to assets resulting from activities that transform an item of agricultural inventory into a different asset (secondary production). Such assets would be within the scope of other Sections such as Section 3031, *Inventories*.

Recognition

- Agricultural inventories and productive biological assets must meet the definition of an asset and the recognition criteria in Section 1000, *Financial Statement Concepts*, in order to be recognized.
- Biological assets not used in a productive capacity are presumed to be agricultural inventories on initial recognition. An agricultural producer can choose to rebut this presumption on initial recognition when its intention is to develop the asset into a productive biological asset.

Measurement of agricultural inventories

- An agricultural producer makes an accounting policy choice to measure agricultural inventories using the cost model or the net realizable value model. The net realizable model can only be applied when all the following conditions are met:
  i. the product has a reliable, readily determinable, and realizable market price;
  ii. the product has reliably measurable and predictable costs of disposal; and
  iii. the product is available for immediate delivery.
- An agricultural producer that measures agricultural inventories using the cost model then makes another accounting policy choice to determine cost using either full cost or only the input costs.
- Agricultural inventories measured using the cost model are measured at the lower of cost and net realizable value.
- For agricultural inventories measured using the net realizable value model, changes in net realizable value after initial recognition are recognized in net income.

Measurement of productive biological assets

- Productive biological assets are measured at cost less accumulated amortization and impairment, if any.
- Productive biological assets managed on a collective basis to maintain their collective productive capacity indefinitely (such as a herd of livestock) are not amortized but are tested for impairment.
- When a productive biological asset is no longer used in a productive capacity, it is measured at the lower of its carrying amount and fair value less costs to sell until it is sold or disposed of other than by sale. The asset is no longer amortized.

Change in use

- When an agricultural producer starts using an item of agricultural inventory in a productive capacity, it would reclassify the item from agricultural inventories to productive biological assets. The carrying amount of the item of agricultural inventory would be the deemed cost of the productive biological asset on reclassification.

- Productive biological assets are not reclassified to agricultural inventories.

Presentation

- The amount of agricultural inventories and productive biological assets must be presented as separate line items on the agricultural producer's balance sheet.

Section 3041 is effective for fiscal years beginning on or after January 1, 2022. It is applied retrospectively, with simplified transitional provisions. Refer to our ASPE at a Glance: Section 3041 – Agriculture publication and our "What you should know about the new agriculture financial reporting standard" publication to learn more.

Projects on the Go

The AcSB currently has a number of projects in progress that propose future changes to the ASPE Handbook. The following provides a brief discussion of these projects.

Exposure Draft – Customer's Accounting for Cloud Computing Arrangements

Recently, more entities have begun using cloud-computing arrangements to access software. In the past, entities would do an outright purchase of software that would then be physically installed onto their own hardware. In a cloud computing arrangement, customers have the right to use software through remote access whereby the actual software resides on the vendor's hardware. These arrangements contain varying contractual terms and the accounting can be complex, which has led to diversity in practice. There are also concerns that the accounting outcome for implementation expenditures incurred for an arrangement that is a service contract does not reflect the economic benefits an entity receives over time. The AcSB heard stakeholders' concerns, and in March 2022 issued an Exposure Draft proposing the issuance of Accounting Guideline AcG-20, *Customer's Accounting for Cloud Computing Arrangements*, to provide guidance on this topic. The main proposals include:

- Clarification that an entity may determine a method on a rational and consistent basis to allocate the arrangement consideration to the significant separable elements in a cloud computing arrangement;
- Clarification that an entity applies Section 3064, Goodwill and Intangible Assets, to account for the significant elements in the arrangement, unless the elements are tangible assets or rights to use tangible assets;
- An optional simplification approach to permit an entity to expense as incurred the expenditures related to the elements in a cloud computing arrangement that would fall within the scope of Section 3064;
- For those entities that do not apply the simplification approach, the Guideline provides factors to assist them in applying the control principle in Section 3064 to determine whether the cloud computing arrangement includes a software intangible asset;
- For a software that is a service, there is an accounting policy choice to either:
  - Apply an exception to capitalize directly attributable implementation costs and present these costs as prepaid expenses; or
  - Continue to expense as incurred such implementation costs in accordance with the existing requirements in Section 3064;
- Disclosure requirements to help users understand how the cloud computing arrangement is accounted for in the entity's financial statements; and
- Illustrative examples to assist entities in applying the guidance.

The Board approved the issuance of AcG-20 at its September 2022 meeting and anticipates issuing it in the Handbook in November 2022. AcG-20 will be effective for fiscal years beginning on or after January 1, 2024, with earlier application permitted. The Guideline will be applied retrospectively, with certain transitional relief.

Project – Financial Statement Concepts

In March 2019, the AcSB approved a project to review the financial statement concepts in both Part II and Part III of the CPA Canada Handbook. The project will focus on:

- Elements (definition of an asset, liability, revenue and net assets);
- Recognition;
- Measurement;
- Disclosure; and
- Unit of account

The first items to be addressed will be the definition of an asset and liability.

Project – Related Party Combinations

The results of an AcSB survey of stakeholders on the priority of projects for domestic standards, identified Section 3840, *Related Party Transactions*, as a high priority. An area of concern identified by stakeholders was accounting for related party combinations. Specifically, the current guidance in paragraph 3856.44 on accounting for a business transferred between two enterprises under common control is not clear and often causes application difficulties in practice. Additionally, it is unclear whether financial instruments transferred in such a transaction should be measured using the principles in paragraph 3856.44 or Section 3856, *Financial Instruments*.

As a result, the Board has undertaken a project on related party combinations. As part of this project, the Board plans to issue an Exposure Draft in November 2022 proposing the removal of the reference to “exchange amount” in paragraph 3840.44(a) to clarify that business combinations under common control that meet the requirements of this paragraph should be accounted for using Section 1582, *Business Combinations*, as well as, proposing to revisit the requirement in paragraph 3840.44(b) to retroactively restate comparatives.

Conclusion

As we head closer to the end of the year, now is the time to check in with your BDO advisor about how the impacts of COVID-19, the changes made to the ASPE Handbook and the projects on the go will affect your organization. Reach out to us today.