Focus on financial reporting

2017 Annual update

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Introduction

Financial reporting is not just about technical compliance, but also effective communication. Investors continue to ask for a step-up in the quality of business reporting, so preparers should be careful not to become buried in compliance to the exclusion of relevance. In preparing their financial statements, entities need to focus on improving their communication by reporting financial information in a meaningful way and innovating their financial statement presentation and disclosure in the broader context of better business reporting.

In the prior year, the International Accounting Standards Board (IASB) confirmed that the theme for its activities until 2021 will be *"Better Communication"* in financial statements. The IASB aims to improve the communication effectiveness of financial statements by taking a fresh look at how financial information is presented and grouped together. While the US Financial Accounting Standards Board (FASB) has continued to work on new standard-setting projects, its short-term agenda is also focused on more narrowly-scoped projects geared toward simplifying or clarifying current accounting guidance. While the objectives of the IASB and FASB are similar, the projects are no longer being jointly developed.

The effective date for the IASB's and FASB's new *Revenue and Financial Instruments Standards* is finally here. The new *Revenue and Financial Instrument Standard*s will take effect January 1, 2018 (except for the FASB's *Impairment Standard*). Collectively, the adoption of these standards has required significant time and resources. As companies prepare their 2017 annual financial statements (assuming a calendar year end) it is imperative to remember that there is an expectation from regulators and investors, and a requirement under the respective accounting frameworks, that detailed and entity specific disclosures will be provided with respect to the impact of the new standards, and the adoption and implementation efforts. These disclosures should include both qualitative and quantitative data and should be sufficiently robust to provide users with decision useful information. Even for those entities that anticipate little change to the statement of financial position or statement of profit or loss, the changes related to disclosures may be material. When assessing the impact of the new standards, entities should consider possible changes to recognition, measurement, presentation, and disclosures.

The effective date of the new leases standard is also rapidly approaching. The IASB and FASB's *Leases Standards* are effective January 1, 2019. Although IFRS 16 and ASC Topic 842 are not the stars of the show from a disclosure perspective this year, they are still very much on the radar for regulators and stakeholders. While the implementation projects are underway, consider discussing the status of your project, including anticipated timelines, and potential implications for internal controls and processes, as well as information technology.

The impact of the new standards is not limited to accounting. The implementation of the new standards will have an impact on internal controls over financial reporting, including controls over measuring the transition adjustments and preparing the expanded disclosures, and could result in new risks or changes to previously identified risks, including fraud risks. Companies need to update accounting policies and related manuals, accounting technical papers, process flowcharts, and the design of related internal controls and their assessments of those internal controls. Public companies should disclose those changes that have materially affected, or are reasonably likely to materially affect, their internal controls over financial reporting in accordance with the entities' regulatory framework.

For 2017, the Accounting Standards Board (AcSB) held true to its commitment to minimize the frequency of changes to Accounting Standards for Private Enterprises (ASPE). The 2017 annual improvements were released in July 2017 and two exposure drafts, *Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement (formerly Redeemable Preferred Shares Issued in a Tax Planning Arrangement)* and *Accounting for Related Party Financial Instruments and Significant Risk Disclosures – Proposed Amendments to Section 3856, Financial Instruments*, were issued in the fall of 2017. Additionally, the AcSB continues to work towards the issuance of an exposure draft on *Agriculture* in 2018. The AcSB also started its consultation process with stakeholders in setting the relative priorities of future ASPE projects.

This publication is intended to help boards of directors, audit committee members, corporate management and other interested parties to identify and address International, Canadian, US regulatory and other

financial reporting developments that may affect their organizations. To facilitate ease of finding the information most relevant to your organization, we have arranged this publication by organization type and the applicable financial reporting framework.

The information in this edition is based on pronouncements released prior to November 15, 2017. For pronouncements released after this date, please refer to the website of the standard setter or regulator in question, or contact your KPMG adviser.

Focus on financial reporting is of a general nature, intended solely to increase awareness of financial reporting developments. Readers should consult the original pronouncements and/or their financial advisers for detailed guidance on the application of these standards.

Ways KPMG can help

KPMG professionals assist clients in understanding their financial reporting frameworks, be it International Financial Reporting Standards (IFRS), US GAAP, Accounting Standards for Private Enterprises (ASPE), or standards applicable to not-for-profit or public sector organizations or pension plans. Additionally, we have a range of publications and resources addressing developments in these areas and the implications for Canadian enterprises.

Publicly accountable enterprises

Update on IFRS

The Current Developments: IFRS publications, available on the *Audit Committees Institutes* section on kpmg.ca, summarize major developments including upcoming financial reporting matters and ongoing standard setting and other activities. The following are links to the Current Developments publications referred to in this section:

Current Developments: IFRS – Q1 2017

Current Developments: IFRS – Q2 2017

Current Developments: IFRS – Q3 2017

The following amendments were issued in prior years and became effective for annual periods beginning on or after January 1, 2017:

- *Disclosures of Changes in Financial Liabilities* (Amendments to IAS 7) – requires disclosures that enable users to evaluate changes in liabilities arising from financing activities, including both cash and non-cash changes.
- *Recognition of Deferred Tax Assets for Unrealized Losses* (Amendments to IAS 12) – clarifies that the existence of a deductible temporary difference for debt instruments measured at fair value is dependent solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and clarifies the methodology to determine future taxable profits for the purpose of the recognition of a deferred tax asset.
- *Annual Improvements to IFRSs 2014 – 2016 Cycle* – IFRS 12 *Disclosure of Interests in Other Entities* – clarifies that disclosure requirements in IFRS 12 also apply to interests that are classified as held for sale or distribution.

For details of the above amendments, refer to *Focus on financial reporting 2016*.

In addition, there have been a number of IFRS developments, including new and proposed standards, amendments to existing guidance, interpretations and narrow-scope amendments, some of which could raise significant implementation and reporting concerns for Canadian companies in the near future.

New guidance issued and reminders on major standards

The following is a summary of new guidance issued by the IASB since the previous edition of *Focus on financial reporting* was released and reminders on major standards.

IFRS 15 – Revenue Standard

The January 1, 2018 effective date for IFRS 15 *Revenue from Contracts with Customers* is almost here and implementation efforts are expected to be well underway. The implications of IFRS 15 can be pervasive – impacting everything from earnings before interest, taxes, depreciation and amortization (EBITDA) to systems and processes, including internal controls.

As a reminder, IFRS 15 replaces existing guidance and introduces a new model for revenue recognition that is based on the transfer of control. This may affect the timing and amount of revenue that entities will recognize compared with current practice. For some entities there may be little change. However, arriving at this conclusion will require an understanding of the new model and an analysis of how it is applied to particular transactions.

Regardless of the extent of the impact on the revenue line, all companies are impacted by the disclosure requirements of IFRS 15. IFRS 15 contains both quantitative and qualitative disclosure requirements for annual and interim periods. Under the new standard, an entity discloses more information about its

contracts with customers than is currently required under IAS 18 *Revenue* and IAS 11 *Construction Contracts*, including more disaggregated information abour revenue and more information about the entity's performance obligations at the reporting date.

The objective of the disclosure requirements is to provide sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Entities will need to assess whether their current systems and processes are capable of capturing, tracking and aggregating, and reporting information to meet the new disclosure requirements. This may require significant changes to existing data gathering processes, IT systems and internal controls.

Additionally, entities need to consider their transition disclosures for the 2017 calendar year-end annual finanical statements (refer to introduction).

For more information, refer to *Current Developments: IFRS – Q3 2017* and *IFRS 15 Revenue supplement – Guide to Annual Financial Statements (IFRS)*.

IFRS 9 – Financial Instruments

The effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018, and is rapidly approaching. IFRS 9 brings fundamental changes to financial instruments accounting and replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

Classification and measurement

Companies will need to assess their business model for managing financial assets, and whether the cash flows from the financial assets are solely payments of principal and interest (SPPI), in order to classify them. The classification criteria are significantly different from those under IAS 39.

For financial liabilities, the classification and measurement requirements of IAS 39 are largely unchanged.

For financial liabilities designated at fair value through profit or loss (FVTPL) changes are generally presented as follows:

- the change in fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining change in fair value is presented in profit or loss.

There are two exceptions to the split presentation between profit or loss and OCI for financial liabilities designated as at FVTPL:

- if split presentation would create or enlarge an accounting mismatch in profit or loss; or
- if a financial liability is a loan commitment or financial guarantee.

In these cases, all gains and losses are presented in profit or loss.

Impairment

The requirements for financial asset impairment have also changed significantly, moving from an 'incurred' to an 'expected' credit loss (ECL) model. This means that under IFRS 9 – unlike under IAS 39 – a loss event need not occur before an impairment loss is recognised.

Hedge accounting

If a company chooses to apply IFRS 9's general hedging model, more risk management strategies could qualify for hedge accounting. This is because the new hedging model is more closely aligned with a company's risk management objectives.

As a reminder, entities have the option to defer adoption of IFRS 9's hedge accounting requirements, and continue to apply IAS 39 hedging accounting requirements in their entirety to all of their hedging relationships, until the standard resulting from the IASB's dynamic risk management project is completed.

Unexpected changes may also arise as the new standard has fundamental differences compared with existing financial instruments accounting. Therefore, it's essential that the accounting impacts are considered in detail, as well as the broader business impacts – e.g., the impact on tax.

Similar to the revenue standard, the adoption of IFRS 9 will have an impact on the level of required disclosures, with respect to both the transition disclosures in the 2017 annual financial statements and new disclosure requirements under the standard as IFRS 9 requires more detailed disclosures about credit risk management and hedge accounting.

Prepayment features with negative compensation

For a debt instrument to be eligible for measurement at amortized cost or fair value through other comprehensive income (FVOCI), IFRS 9 requires its contractual cash flows to meet the SPPI criterion – i.e. the cash flows are 'solely payments of principal and interest'.

Under IFRS 9 (as issued in 2014), a prepayment option in a financial asset meets this criterion if the prepayment amount substantially represents unpaid amounts of principal and interest, which may include 'reasonable additional compensation' for early termination of the contract.

Some prepayment options in financial assets could result in the party that triggers the early termination receiving compensation from the other party (negative compensation) – e.g., a lender could receive an amount less than the unpaid amounts of principal and interest even though the borrower chose to prepay. In other cases, an event outside the control of both parties may cause early termination.

Applying IFRS 9 would probably result in these instruments being measured at FVTPL as the asset would not meet the SPPI criterion. The IASB believes this to be inappropriate because measuring them at amortized cost, using the effective interest method, provides useful information about the amount, timing and uncertainty of their future cash flows. Therefore, in October 2017, the IASB issued *Prepayment Features with Negative Compensation* (Amendments to IFRS 9).

The amendments enable particular financial assets with prepayment features that may result in negative compensation, such as a 'make whole' prepayment option or a fair value prepayment option, to be measured at amortized cost or at fair value through other comprehensive income (subject to the financial asset meeting the business model condition) if certain conditions are met.

The effective date of the amendments is annual periods beginning on or after January 1, 2019, one year after the effective date of IFRS 9, with earlier application permitted. The amendments will require retrospective application with specific transition provisions and disclosures.

Modification of financial liabilities that do not result in derecognition

Companies that have modified or exchanged fixed rate financial liabilities face a significant change in the accounting for non-substantial modifications that do not result in derecognition.

Common practice under IAS 39 is to recalculate the effective interest rate (EIR) at the modification date to reflect the revised contractual cash flows, without recognizing a gain or loss at that date.

The IASB clarified that IFRS 9 requires preparers to:

- recalculate the amortized cost of the modified financial liability by discounting the modified contractual cash flows using the original EIR; and
- recognize any adjustment in profit or loss.

The accounting treatment is therefore consistent with that required for modifications of financial assets that do not result in derecognition.

If the initial application of IFRS 9 results in a change in accounting policy for these modifications or exchanges, then retrospective application is required, subject to particular transitional reliefs.

There is no change to the accounting for costs and fees when a liability has been modified (but not substantially) – these are recognized as an adjustment to the carrying amount of the liability and are amortized over the remaining term of the modified liability.

The IASB has highlighted in the Basis of Conclusions in the IFRS 9 Amendments – *Prepayment Features with Negative Compensation* that the requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition and no further standard-setting is required.

For more information, refer to KPMG's *web article* and *Current Developments: IFRS – Q1 2017 and Q3 2017*.

IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16 *Leases*. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, IFRS 16 introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting. And while lessor accounting remains substantially similar to current practice – i.e., lessors continue to classify leases as finance or operating leases, there are some minor changes, including the fact that lessors look to IFRS 15 to split the lease component of a contract from non-lease components.

The new standard is effective for annual reporting periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15.

All entities that lease major assets for use in their business will see an increase in reported assets and liabilities. In addition, entities will also now recognize a front-loaded pattern of expense for most leases, even when they pay constant annual rentals. This will affect a wide variety of organizations across all industries that lease real estate, equipment, and vehicles. The larger the lease portfolio, the greater the impact on key reporting measures.

The new standard makes the distinction between contracts that meet the definition of a lease and a service contract even more critical, as leases will now be recognized on the balance sheet. There may be a number of arrangements that are currently accounted for as leases that fall outside the new definition of a lease introduced in IFRS 16. The new definition increases the focus on who controls the use of the underlying asset throughout the term of the arrangement. On transition, companies can choose whether to apply a practical expedient to 'grandfather' their previous assessment of which contracts are, or contain, leases.

Lessee Accounting

For each major lease, a lessee will recognize a liability for the present value of future lease payments. The lease liability will be measured at amortized cost using the effective interest rate, which creates a front-loaded interest expense. The lessee will also recognize a 'right-of-use' asset, which will be measured at the amount of the lease liability plus initial direct costs, prepaid lease payments, and estimated costs to dismantle, less any incentives received. Lessees will generally depreciate the right-of-use asset on a straight-line basis.

What discount rate?

A key estimate in IFRS 16 relates to the discount rate used to measure the present value of the lease payments. While the definitions of the discount rate are consistent with IAS 17 Leases, the application of these definitions in the new standard may be complex, especially for lessees, as a discount rate will have to be determined for most leases previously classified as operating leases. The exceptions are leases for which the lessee applies the recognition exemptions. The determination of the appropriate discount rate will be particularly demanding at transition, especially if IFRS 16 is adopted retrospectively.

Estimating discount rates and documenting the basis of those estimates will be a major task. To help you prepare to adopt IFRS 16, KPMG has recently published, *Leases Discount Rates – What's the correct rate?*, which provides an overview of how to determine the appropriate discount rate and how this will affect your financial statements.

What's included in the lease liability?

The lease liability is measured at the present value of the lease payments. But the determination of which lease payments should be included in the lease liability, initially and subsequently can be challenging as the detailed rules are different than current practice.

One key difference is that certain lease payments are reassessed over the term of the lease, and the lease liability adjusted accordingly. This introduces new balance sheet volatility. It also requires new systems and processes to determine the revised lease payments and recalculate the lease liability.

There is a less dramatic impact on lessors. For them, a key focus will be allocating the consideration in contracts with multiple components to determine the lease payments. This will sometimes be a disclosure-only question, but those disclosures could be sensitive for some lessors.

Identifying the relevant payments to include in the liability is key to measuring the lease liability. KPMG has recently published *Lease payments – What's included in the lease liability?*, which provides an overview of how to determine the lease payments.

What have we learned?

Now that companies are starting to make headway on their IFRS 16 conversion projects, we're making some unexpected discoveries about how the new leasing standard is being implemented in practice.

Some companies have found that the standard enhances some key earnings metrics and others have concluded that some of the practical expedients are not as advantageous as they first thought.

Some of the challenges and insights that have been seen in the implementation stage include:

- creating an inventory of lease contracts and extracting the data from the lease contracts: this process will take time and is process-heavy, so running parallel work streams to keep the project on track will be important, especially if your project plan includes a software implementation; and
- identification of embedded leases: under the existing standard it makes little difference whether a contract is classified as an operating lease or as a service. But it does under the new standard. The analysis of whether a component of a contract meets the definition of a lease is proving more difficult than anticipated.

For more information, refer to *Current Developments*: IFRS – Q1, Q2, and Q3 2017 and our web article.

New: IFRS 17 Insurance Contracts

In May 2017, the IASB issued the new insurance contracts standard – IFRS 17 – which will bring fundamental changes to insurance accounting. The new standard will give users of financial statements a whole new perspective, and the ways in which analysts interpret and compare companies will change. The impact on insurers is significant, but will vary between insurers and jurisdictions.

Benefits of the new standard include increased transparency about the profitability of new and in-force business which will provide more insight into an insurer's financial health. Other effects may include greater volatility in financial results and equity due to the use of current discount rates and assumptions around future cash flows.

Other changes include:

- separate presentation of underwriting and finance results, providing information surrounding the sources of profit and quality of earnings;
- premium volumes will no longer drive the 'top line' as investment components and cash received are no longer considered to be revenue;
- accounting for options and guarantees will be more consistent and transparent.

IFRS 17 applies not only to entities that are generally considered insurance entities, but to all entities that:

- issue insurance or reinsurance contracts;
- hold reinsurance contracts; or
- issue investment contracts with a discretionary participation feature (provided that they also issue insurance contracts).

IFRS 17 introduces:

- a single measurement model based on a current fulfillment value that incorporates available information in a way that is consistent with observable market information; and
- a single revenue recognition principle to reflect services provided.

IFRS 17 becomes effective January 1, 2021; however, the timescale will be a challenge and implementation will require the coordination of several functions, including Finance, Actuarial, and IT as well as the introduction of new or upgraded systems, processes and controls.

This is a historic moment for everyone in the insurance industry. The waiting is over and it is imperative that insurers start to prepare themselves to implement IFRS 17 and ensure clear, concise and robust communication to shareholders, investors and other key stakeholders.

In September 2017, the IASB established a Transition Resource Group (TRG) for IFRS 17 that will be responsible for analyzing implementation related questions on IFRS 17.

For more information, refer to Current Developments: IFRS – Q3 2017 and the Insurance Hot Topics webpage.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

IFRS 17 is effective for annual periods beginning on or after January 1, 2021, well after the effective date of IFRS 9, January 1, 2018. As the majority of an insurer's investments are covered by IFRS 9, the differing effective dates have created concerns related to temporary volatility and accounting mismatches in profit or loss. Some companies have also expressed concerns about the need to implement two significant changes in accounting on different dates, which will increase costs and complexity.

In September 2016, the IASB issued amendments to its existing insurance contracts standard, IFRS 4. The amendments introduced two approaches that supplement existing options in the Standard that can be used to address the temporary volatility as a result of the different effective dates; a temporary exemption from the application of IFRS 9 or an option to remove from profit or loss the incremental volatility caused by changes in the measurement of specified financial assets upon application of IFRS 9 (referred to as the 'overlay approach').

In March 2017, the Office of the Superintendent of Financial Institutions (OSFI) issued an advisory articulating its expectation that life insurers whose activities are predominately connected with insurance are to apply the temporary exemption from IFRS 9 in annual periods beginning before January 1, 2021. An exception is available for federally regulated life insurers if the federally regulated parent does not meet the predominance test.

For more information, refer to *Current Developments: IFRS – Q3 2017*.

Other guidance effective for annual periods beginning on or after January 1, 2018 and beyond

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

In June 2016, the IASB published amendments to IFRS 2 *Share-based Payment – Classification and Measurement of Share-based Payment Transactions* to resolve ambiguity about how to account for certain types of arrangements in IFRS 2 *Share-based Payment*.

The new requirements could affect the classification and/or measurement of these arrangements – and potentially the timing and amount of expense recognized for new and outstanding awards.

The amendments provide clarification on the following:

- *Measurement of cash-settled share-based payments* –a cash-settled share-based payment is measured using the same approach as equity-settled share-based payments (i.e., the modified grant date method).
- *Classification of share-based payments settled net of tax withholdings* – amendments clarify the conditions under which a share-based payment transaction with employees settled net of tax withholdings is accounted for as equity-settled.
- *Accounting for a modification of a share-based payment from cash-settled to equity-settled* – the amendments clarify that at the modification date the difference between the liability for the original cash-settled share-based payment derecognized and the equity-settled share-based payment (measured at its fair value as at the modification date and recognized to the extent that the services have been received up to that date) is recognized immediately in profit or loss.

The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early application is permitted if information is available without the use of hindsight.

For more information, refer to *Current Developments: IFRS – Q3 2017*.

Annual Improvements to IFRSs 2014-2016 Cycle

In December 2016, as part of its process to make non-urgent but necessary amendments to IFRS, the IASB issued narrow-scope amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, and IAS 28 *Investments in Associates and Joint Ventures.*

For more information, refer to *Current Developments: IFRS – Q3-2017*.

Transfer of Investment Property (Amendments to IAS 40)

In December 2016, the IASB issued Transfers of Investment Property (Amendments to IAS 40).

The amendments clarify that:

- an entity shall transfer a property to, or from, investment property when, and only when, there is a change in use of a property supported by evidence that a change in use has occurred; and
- the list of circumstances when a change in use has occurred is non-exhaustive.

The amendments are effective for annual periods beginning on or after January 1, 2018. The transitional provisions allow an entity to apply the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the amendments are applied. Retrospective application is permitted in accordance with IAS 8, but only if it does not involve the use of hindsight.

For more information, refer to *Current Developments: IFRS – Q3 2017*.

Long-term Interests in Associates and Joint Ventures (Amendments to IFRS 9 and IAS 28)

There has always been diversity in practice when accounting for the share of losses of an associate or joint venture after the equity interest has been reduced to nil. The share of further losses is required to be allocated to long-term interests, but how does that modify the financial instruments' accounting requirement for such loans?

The introduction of new impairment requirements in IFRS 9 based on expected credit losses exacerbated the issue and prompted the IASB to find a solution before IFRS 9 becomes effective.

In October 2017, the IASB issued narrow-scope amendments to IAS 28 *Investments in Associates and Joint Ventures*, clarifying that an entity applies IFRS 9 (including its impairment requirements) to long-term interests in an associate or joint venture to which the equity method is not applied. The IASB also published an illustrative example on how to apply the amendment.

The amendment to IAS 28 will affect companies that finance such entities with preference shares or with loans for which repayment is not expected in the foreseeable future (referred to as long-term interests or 'LTI'). This is common in the extractive and real estate sectors.

The amendment applies for annual periods beginning on or after 1 January 2019. Early adoption is permitted. There are transitional reliefs.

For more information, refer to KPMG's *web article*.

Other Guidance

Practice statement 2: Making materiality judgements

In September 2017, the IASB issued Practice Statement 2: *Making Materiality Judgements.* The practice statement is non-mandatory guidance on how to apply the concept of materiality, so that financial statements focus on information that is useful to investors rather than using the disclosure requirements within IFRS as a checklist.

The Practice Statement does not change requirements or introduce new requirements.

The guidance can be applied to financial statements prepared after September 14, 2017.

For more information, refer to *Current Developments: IFRS – Q3 2017*.

IFRS Interpretations Committee Agenda Decisions

In December 2016, the IASB issued IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration* in response to diversity in practice in determining the appropriate exchange rate to use when translating assets, expenses or income, when foreign currency consideration is paid or received in advance of the item to which it relates.

The Interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognized the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date.

The Interpretation is applicable for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

An entity should consider the impact on net profit or loss, the interaction of IFRIC 22 with other standards, and possible changes to accounting systems.

For more information, refer to *Current Developments: IFRS – Q1 2017*.

Uncertainty Over Income Tax Treatments (IFRIC Interpretation 23)

In June 2017, the IASB issued IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* in response to diversity in practice for various issues in circumstances in which there is uncertainty in the application of the tax law. While IAS 12 *Income Taxes* provides requirements on the recognition and measurement of current and deferred tax liabilities and assets, there is diversity in the accounting for income tax treatments that have yet to be accepted by tax authorities.

The Interpretation requires:

- an entity to determine if it is probable that the tax authorities will accept the uncertain tax treatment; and
- if it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value depending on whichever method better predicts the resolution of the uncertainty;
- an entity to reassess the judgements and estimates applied if facts and circumstances change (e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority's right to challenge a treatment expires); and
- an entity to consider whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution.

The Interpretation is applicable for annual periods beginning on or after January 1, 2019 and may be applied on a fully retrospective basis, if this is possible without the use of hindsight, or on a modified retrospective basis, with an adjustment to equity on initial application. Earlier application is permitted.

For more information, refer to *Current Developments: IFRS – Q3 2017*.

Interest and Penalties Related to Income Taxes

IFRS Standards do not specifically address the accounting for interest and penalties related to income taxes (interest and penalties). In the light of the feedback received on the draft IFRIC Interpretation *Uncertainty over Income Tax Treatments*, the IFRIC considered whether to add a project on interest and penalties to its standard-setting agenda. In September 2017, the IFRIC decided not to add this project to its standard setting agenda.

In September 2017, the IFRIC observed that entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties. Rather, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If the particular amount payable or receivable is not considered an income tax, then IAS 37 is applied to that amount. In accordance with IAS 1 *Presentation of Financial Statements*, disclosures are made about the judgements that have had the most significant effect on the amounts recognized in the financial statements.

The IFRIC agenda decision is effective immediately. As a result of this clarification, current accounting treatments will need to be re-examined to determine if a change is required. If required, a change in accounting policy is applied retrospectively in accordance with IAS 8.

For more information, refer to the *Current Developments: IFRS – Q3 2017*.

Guidance Currently Under Development – Narrow-scope Amendments

The following is a list of some current IASB projects and exposure drafts that may impact your financial statements in the future.

Forthcoming IFRS amendments:

- *Income tax consequences of payments on instruments classified as equity* (Amendments to IAS 12) – clarifies that all income tax consequences of distribution of profits are recognized in profit or loss, including payments on financial instruments classified as equity.
- *Borrowing costs eligible for capitalization* (Amendments to IAS 23) – Specific borrowings – i.e. funds borrowed specifically to finance the construction of a qualifying asset – should be transferred to the general borrowings pool once the construction on the qualifying asset has been completed.
- *Previously Held Interests in a Joint Operation* (Amendments to IFRS 3 and IFRS 11) – Clarify how a company accounts for obtaining control (or joint control) of a business that is a joint operation if the company already holds an interest in that business.
- *Classification of Liabilities* (Amendments to IAS 1) – confirmation that the classification as current/non-current is based on facts and circumstances at the reporting date, and modifies the existing classification criteria.
- *Definition of a Business* (Amendments to IFRS 3) – clarification of how to distinguish between a business combination and asset acquisition.
- *Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19) and *Availability of a Refund* (Amendments to IFRIC 14) – amendments help clarify the accounting for a plan amendment, curtailment or settlement, and help to determine an entity's right to a refund when other parties, such as trustees, have powers to enhance pension benefits and/or wind up the plan without the entity's consent.

Exposure drafts:

- Proposed Improvements to IFRS 8 *Operating Segments* – proposed amendments seek to address the concerns of preparers, regulators, and users of financial statements as a result of the post implementation review of IFRS 8 by providing new disclosure requirements and clarifying aspects of IFRS 8.
- *Accounting Policies and Accounting Estimates* (Proposed Amendments to IAS 8) – proposed clarifications to distinguish accounting policies from accounting estimates.
- *Definition of Material* (Proposed Amendments to IAS 1 and IAS 8) – proposed amendments refine the definition of material and clarify its application in the existing requirements.
- *Property, Plant and Equipment – Proceeds before Intended Use* (Amendments to IAS 16) – proposed amendments seek to provide clarify on how companies account for the proceeds from selling items produced while testing an item of plant or equipment before it is used for its intended purpose.
- Disclosure Initiative: *Principles of Disclosure* – objective is to identify disclosure issues and develop new, or clarify existing, disclosure principles and to help improve the effectiveness of disclosures for the primary users of the financial statements.

For more information, refer to *Current Developments: IFRS – Q1 to Q3 2017* and the IASB's work plan.

Other financial reporting considerations for all entities

Accounting Implications of Rule Changes by Central Clearing Parties Impacting Derivatives, Hedge Accounting and Taxation

Certain rule changes have been implemented by central clearing parties (CCP(s)) that may have accounting and financial reporting implications for entities with derivative contracts. The rule changes relate to the treatment of certain margin accounts, involving a move towards a settled-to-market (STM) – as opposed to collateralized-to-market (CTM) – framework for cleared derivative transactions.

On January 3, 2017, the Chicago Mercantile Exchange (CME) clarified through rule changes the effect of payment of variation margin within the daily settlement process of certain Exchanges. Under the rule changes, payment of variation margin results in certain derivative contracts being settled on a daily basis (STM) instead of the posting of collateral (CTM). The rule changes will require an entity to evaluate whether the legal characterization of variation margin payments should be viewed as settlement of the outstanding exposure of the contract, rather than the posting of collateral. When a payment represents a partial legal settlement of the contractual rights under the derivative contract, this will result in a corresponding amount of the derivative being derecognized.

Other clearing houses have made rule changes to effect similar settled-to-market provisions. In some instances, it appears that the change to settled-to-market regime is voluntary on a derivative by derivative basis based on an election by the entity.

The expectation under IFRS is that the effects of the rule changes will be reflected prospectively as of the effective date, and will affect existing and new interest rate swaps, credit default swaps and base guaranty fund products cleared through the impacted Exchanges.

For US issuers, based on discussions with the SEC staff, end-users and clearing members will not need to discontinue existing hedge accounting relationships as a result of the rule changes.

For more information refer to *Current Developments: US - Q1 2017* and *IFRS Q1 2017*.

Income Tax Implications of Brexit

On March 29, 2017, the UK formally notified the European Council of their intention to withdraw from the European Union (EU). The notice initiated a two-year negotiation period to establish the withdrawal terms. If no agreement is reached after two years, the UK's separation becomes effective, unless the remaining EU members unanimously agree to an extension.

The elevated economic uncertainty of Brexit may impact financial reporting in regards to asset valuations, inventory values, onerous contracts, deferred tax asset recognition, recoverability of receivables, covenant compliance, hedge effectiveness testing, and going concern assessments.

Additionally, uncertainty exists as to which tax laws will apply to the UK and the EU member states after the exit, and how the UK's tax status may change. The outcome of these events should be monitored as the negotiations process continues. Enhanced disclosure may be required so that users are able to understand the effects of the events on the entity's financial position, financial performance, and cash flows – in particular, disclosure of risks, significant judgments and key assumptions in the financial statements. Entities should also consider the effects on their short- and long-term business strategies and commitments.

For more information refer to *Current Developments*: *IFRS – Q1 2017* and *US SEC and Financial Reporting Developments: Q3 2017*.

Foreign Private Issuers now have XBRL Reporting Requirements

In March 2017, the US Securities and Exchange Commission (SEC) issued a notice that the IFRS taxonomy had been published on the SEC's website, which will require foreign private issuers (FPIs) preparing their financial statements in accordance with IFRS to submit those financial statements in interactive data format (XBRL).

FPIs that prepare financial statements in accordance with IFRS will have to file their financial statements and notes to the financial statements, as well as any applicable schedules to the financial statements in XBRL format as a new separate exhibit to their Form 20-F or Form 40-F annual report, and also post the information to their corporate websites on the same date as the filing.

The requirements are effective for annual reports on Form 20-F or Form 40-F relating to fiscal years ending on or after December 15, 2017.

For more information, refer to *Current Developments: IFRS – Q1 2017*.

Canadian Regulatory Developments Applicable to all Issuers

The following is a summary of recent Canadian securities regulatory rules, instruments, policies, and documents that are applicable to a broad range of issuers. The summary discusses a number of proposed and final amendments, as well as staff notices issued since the previous edition of *Focus on financial reporting*. As a result of the harmonization efforts of the Canadian Securities Administrators (CSA), securities markets are governed by a number of largely harmonized national or multilateral instruments,

which are on CSA member websites. Many of the links in this document refer to the Ontario Securities Commission (OSC) website; however, readers should refer to the member site in their own jurisdiction.

Canadian securities new guidance

OSC financial reporting bulletin

In November 2016, the Ontario Securities Commission (OSC) issued Staff Notice (SN) 52-*723 Financial Reporting Bulletin* to highlight observations from the Office of the Chief Accountant about various financial reporting topics relevant to reporting issuers that prepare financial statements in accordance with IFRS.

The SN encourages issuers to take a "fresh look" at their financial statement disclosures to consider how information could be more efficiently and effectively presented and to consider financial reports as communication documents rather than a "compliance exercise".

The SN also described the OSC's expectations regarding the adoption of new accounting standards such as IFRS 9, IFRS 15, and IFRS 16. The OSC expects that issuers have begun, or will soon begin, the work necessary to implement the new accounting standards and that issuers will provide increasingly detailed qualitative and quantitative disclosures about the expected effects of the new accounting standards as they make progress in their implementation efforts and the effective dates approach. Audit committees are expected to be actively engaged in oversight of the implementation process. Throughout the SN, the OSC has included questions for management to "consider and assess" how they are addressing the matters raised.

For more details, refer to SN 52-723.

Disclosure reviews

In July 2017, the CSA announced in SN 51-351 *Continuous Disclosure Review Program Activities* for the fiscal year ended March 31, 2017 that it will announce the results of its continuous disclosure review program on a biennial basis instead of annually. The CSA noted that the disclosure considerations published in the prior year are still very relevant and encouraged reporting issuers to continue to apply the guidance in CSA SN 51-346 *Continuous Disclosure Review Program Activities* for the fiscal year ended March 31, 2016.

In September 2017, the OSC released SN 51-728 *Corporate Finance Branch 2016-2017 Annual Report.* Compliance outcomes for full continuous disclosure reviews are noted below (issuers can appear in more than one category):

Outcome	2017	2016
Prospective	72%	57%
Refilings	16%	22%
Education and awareness	2%	15%
Enforcement Referral/Default List	5%	0%
No action	5%	6%

The results of issuer oriented reviews tend to be less comparable depending on the focus from year to year.

The staff notice highlighted the following matters in Part B: Compliance of the Annual Report with respect to Management's Discussion and Analysis (MD&A):

- change in accounting policies including initial adoption – the need to provide increasingly detailed qualitative and quantitative disclosures about the expected impacts of new standards as the effective date approaches (e.g., IFRS 9, IFRS 15, and IFRS 16);

- results of operations – the need to provide increased depth of analysis beyond the percentage change or amount of the various factors that affect revenues and expenses;
- risks and uncertainties – the need for specificity about the material risk and its potential impact and the need to update risk disclosures when circumstances change; and
- liquidity and capital resources – the need to discuss material cash requirements/working capital needs, how these will be met, and how they relate to future business plans and milestones.

Other matters highlighted included non-GAAP measures, forward-looking information, social media disclosures (see SN 51-348), mining disclosures related to preliminary economic assessments, investment entities disclosures (see SN 51-349), the adoption by venture issuers of new quarterly highlights and executive compensation disclosures, disclosures of cyber security risks and incidents (see SN 51-347) and disclosure about women in boards and in executive officer positions (see SN 58-308).

With respect to prospectuses, some of the matters the staff highlighted in the notice include:

- disclosure improvements needed with respect to the description of the business and regulatory environment, risk factors related to the business and/or offering, MD&A disclosure in a long form prospectus, and the use of proceeds;
- inappropriately concluding that an acquisition is an asset acquisition when under securities law it is a business acquisition;
- need for issuers to consider whether additional disclosure beyond the prescribed forms is needed for a prospectus to have full, true and plain disclosure when an issuer is raising proceeds for a significant acquisition that will make up a material portion of its business;
- need for three years of history of the primary business in an initial public offering (IPO) (two years for IPO venture issuer);
- need for an IPO issuer to have an appropriate audit committee in place no later than the receipt of the final prospectus; and
- need to file on SEDAR material contracts (other than those in the ordinary course of business) on which the business is substantially dependent.

Other topics addressed in the Annual Report include:

- Part B: Compliance included Special Purpose Acquisition Reports, the Exempt Market, Exemptive Relief Applications, Insider Reporting and Designated Rating Organizations; and
- Part C: Responsive Regulation addresses Exempt Distribution Reporting, Proposed Foreign Issuer Resale Exemption, Distribution of Securities Outside of Ontario, Syndicated Mortgages, Climate Change Related Disclosure and Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers.

Protection of minority security holders in special transactions

In July 2017, a Multilateral Instrument (MI) SN 61-302 Staff Review and Commentary on Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* was issued by Ontario, Quebec, Alberta, Manitoba and New Brunswick.

The SN outlines the transaction review approach of these regulators and shares their views with respect to:

- the role of boards of directors and/or special committees of independent directors in negotiating, reviewing and approving or recommending material conflict of interest transactions; and
- disclosure obligations that enable security holders to make informed decisions to vote or tender in favour of proposed material conflict of interest transactions.

Material conflict of interest transactions refer to insider bids, issuer bids, business combinations and related party transactions defined in MI 61-101 that give rise to substantive concerns as to the protection of minority security holders (being security holders that are not an interested party in the transaction).

Cryptocurrency offerings

In August 2017, the CSA released SN 46-307 *Cryptocurrency Offerings* to provide guidance regarding what obligations may arise under securities laws when completing offerings such as initial coin offerings (ICO), initial token offerings (ITO) and sales of securities of cryptocurrency investment funds. The staff

observed of the ICO/ITO offerings reviewed to date, in many instances they have concluded that the coins/tokens offered constitute securities for the purposes of securities laws because they represent investment contracts. Staff also observed that many of the products may also be derivatives and subject to derivative laws adopted by the CSA, including trade reporting rules.

The staff notice:

- responds to requests from financial technology (fintech) businesses for guidance on the applicability of securities laws to cryptocurrency offerings and what staff will consider in assessing if an ICO/ITO is a distribution of securities;
- discusses what steps fintech businesses can take if they are raising capital through ICOs/ITOs, so that they comply with securities laws;
- highlights issues that fintech businesses looking to establish cryptocurrency investment funds should be prepared to discuss with staff;
- discusses how the use of cryptocurrency exchanges may impact staff's review of ICOs/ITOs and cryptocurrency investment funds; and
- explains how the CSA Regulatory Sandbox can help fintech businesses with cryptocurrency offerings comply with securities laws through a flexible process which allows firms to register and/or obtain exemptive relief from securities law requirements under a faster and more flexible process than through standard application, in order to test their products, services and applications throughout the Canadian market on a time-limited basis.

Adoption of T+2 settlement cycle

In September 2017, the Amendments to National Instrument (NI) 24-101 *Institutional Trading Matching and Settlemen*t came into force shortening the settlement cycle for equity and long-term debt market trades from three days to two days to align with changes made in the United States.

Also in August 2017, the CSA announced Amendments to NI 81-102 *Investment Funds* and a consequential amendment to NI 81-104 *Commodity Pools* and provided guidance to address conventional mutual funds which were not covered in the NI 24-101 amendments. These amendments were drafted to allow adoption at the same time as the NI 24-101 amendments.

Canadian securities: Proposed guidance

Designated rating organizations

In July 2017, the CSA released proposed Amendments to NI 25-101 *Designated Rating Organizations* and proposed amendments to other securities rules that refer to designated rating organizations (DROs). The proposed amendments relate to DROs and credit ratings of DROs.

The CSA is proposing to amend NI 25-101 to reflect new requirements for credit rating organizations in the European Union (EU) that must be included by June 1, 2018 in order for (a) the EU to continue to recognize the Canadian regulatory regime as "equivalent" for regulatory purposes in the EU and (b) credit ratings of a Canadian office of a DRO to continue to be used for regulatory purposes in the EU. The amendments will also reflect new provisions in the March 2015 version of the IOSCO Code of Conduct Fundamentals for Credit Agencies (the IOSCO Code) of the International Organization of Securities Commissions (IOSCO).

Amendments are also proposed to recognize the credit ratings of the Kroll Bond Rating Agency, Inc. which has filed an application for designation as a DRO. The CSA intends to recognize their credit ratings but only in certain circumstances for issuers of asset-backed securities.

Comments were due by October 4, 2017.

Mutual funds/investment funds

Mandated summary disclosure document for exchange traded mutual funds

In December 2016, the CSA issued amendments to NI 41-101 *General Prospectus Requirements* and related consequential amendments to mandate mutual funds in continuous distribution, the securities of

which are listed and traded on an exchange or alternative trading system (ETFs), to produce and file a summary disclosure document called "ETF Facts", which must be made available on the ETF's or the ETF manager's website. New Form 41-101F4 Information Required in an ETF Facts Document sets out the required contents.

The amendments also introduce a new delivery regime which will require dealers that receive an order to purchase ETF securities to deliver an ETF Facts to investors within two days of the purchase (post sale). Delivery of the prospectus will not be required, but there will be a requirement for the prospectus to be made available to investors upon request, at no cost.

The amendments come into force during 2017.

CSA mutual fund risk classification methodology for use in fund facts and ETF facts

In December 2016, the CSA issued amendments to NI 81-102 *Investment Funds* and related consequential amendments to mandate a CSA risk classification methodology for use by fund managers to determine the investment risk level of conventional mutual funds and exchange-traded mutual funds (ETFs) for use in the Fund Facts document and in the ETF Facts document, respectively. An investment risk level will need to be determined for each filing of the Fund Facts or ETF Facts and at least annually. The rating scale has five categories and investment risk is determined based on standard deviation ranges.

The amendments took effect on September 1, 2017.

As of the effective date, the investment risk level must be determined using the prescribed methodology.

Investment funds practitioner guide

In December 2016, the OSC issued its *Investment Funds Practitioner Guide*. In this issue the following topics were addressed:

- portfolio disclosure practices of exchange-traded funds;
- notification of commencement of an issue-oriented review of scholarship plans registered as Registered Education Savings Plans;
- consideration of different security holder interests by independent review committees;
- application for relief to use notice-and-access procedures for security holder meetings;
- application for relief for mutual funds to be allowed to use cleared swaps;
- reminder for managers of scholarship plans that have made an Undertaking to allow the plans to make limited investments of the income portion of the plans in equity securities that the terms of the Undertaking must be filed on SEDAR no later than the date of the final renewal prospectus for such plans; and
- guidance on mutual fund sales practices.

CSA review of compensation practices in fund industry

In December 2016, the CSA published SN 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*. The notice outlines the results of a survey of practices that surveyed firms used to compensate their representatives, including direct tools such as commissions, performance reviews and sales targets, as well as indirect tools such as promotions and valuation of representatives' books of business for various purposes (for example, retirement and awards).

In addition, the CSA set out their view of the potential material conflicts of interest that could arise from some of these compensation arrangements and other practices to allow firms to more effectively manage potential or actual conflicts of interest that may arise. CSA Staff reminded firms that they consider a conflict of interest to be any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent.

Guidance on small firms compliance and regulatory obligations

In May 2017, the CSA released SN 31-350 *Guidance on Small Firms Compliance and Regulatory Obligations* summarizing the results of a compliance review of 65 small firms registered with the CSA in one or more of the following categories: investment fund manager, portfolio manager and exempt market deals. The firms selected were primarily proprietorships or firms with one registered individual.

The following table summarizes the common deficiencies identified:

Deficiency observed	% with deficiency
Significant business interruptions plan and succession planning – inadequate or missing	35%
Monitoring systems – inadequate written policies and procedures	71%
Monitoring systems – incomplete books and records	25%
Monitoring systems – inadequate marketing materials	15%
Chief Compliance Officer annual report – inadequate or missing	29%
Interim financial statements and accounting policies – incorrect accounting method and insufficient procedures	15%
Inadequate excess working capital	9%
Inadequate relationship disclosure information	63%
Inadequate collection/documentation of know-your-client information	54%
Non-delivery of or inadequate client statements	45%
Inadequate or outstanding filings to regulators	34%

The notice provides further details and guidance with respect to the deficiencies noted.

Ontario exempt market report

In June 2017, the OSC released SN 45-715 2017 *Ontario Exempt Market Report*. The report summarizes capital raising activity by non-investment fund issuers in Ontario's exempt market during 2015 and 2016. Additionally, the report examines capital formation by small Canadian issuers in Ontario's exempt market and the impact of recently introduced prospectus exemptions.

Amendments to registration requirements

In July 2017, the CSA released Amendments to NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations and Related Instruments*.

The amendments were grouped by the regulator into four buckets:

- custody amendments,
- exempt market dealer (EMD) amendments,
- client relationship model amendments; and
- house-keeping amendments.

The custody amendments enhance custody requirements applicable to registered firms that are not members of the Investment Industry Regulatory Organization of Canada (IIROC) or the Mutual Fund Dealers Association of Canada (MFDA) (collectively, Non-SRO Firms). IIROC member firms and MFDA member firms will comply with the custodial regimes of IIROC or MFDA. The custody amendments address potential intermediary risks when Non-SRO Firms are involved in the custody of client assets, enhance the protection of client assets, and codify existing custodial best practices of Non-SRO Firms.

The exempt market dealer amendments clarify the activities that may be conducted under the EMD category of registration in respect of trades in prospectus qualified securities.

The client relationship model amendments make permanent certain temporary relief granted to IIROC and MFDA members with respect to client reporting requirements on the condition that they comply with IIROC and MFDA requirements.

The amendments, other than the custody amendments, came into force on December 4, 2017. The custody amendments come into force June 4, 2018.

Annual summary report for dealers, advisers and investment fund managers

In July 2017, the OSC released SN 33-748 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers*.

The notice covers the following matters:

- outreach to registrants;
- registration of firms and individuals;
- information for dealers, advisers and investment fund managers;
- acting on registrant misconduct;
- key policy initiatives impacting registrants; and
- additional resources.

Applications for registration

- In July 2017, the CSA issued SN 33-320 *The Requirement for True and Complete Applications for Registration* to alert stakeholders to the serious problem of false or misleading applications for registration, to caution them about the potential consequences of submitting such applications, and to provide guidance regarding the completion of the application form.
- An applicant's suitability for registration is determined with reference to three criteria: integrity, proficiency and solvency. If the application contains false or misleading information then it is a red flag that the applicant may be lacking in integrity. False or misleading statements made during the application process may also constitute a provincial or criminal offence. The notice emphasizes that carelessness or misunderstandings are not satisfactory explanations for non-disclosure, then provides examples of typical areas where incorrect interpretations have been made by applicants.

US GAAP Update & US Regulatory Developments

For Canadian SEC registrants that have adopted US GAAP as their reporting framework, the challenge to keep abreast of developments in US GAAP remains. KPMG US's website provides the resources needed to help stay current with US GAAP and US regulatory developments.

The *Current Developments: US* publications, available on the Audit Committees Institutes section on kpmg.ca, summarize major developments including upcoming financial reporting matters and ongoing standard setting and other activities, including FASB, EITF, SEC and PCAOB activities. The following are links to the quarterly *Current Developments: US* publications referred to below.

Current Developments: US – Q1 2017

Current Developments: US – Q2 – 2017

Current Developments: US – GAAP Q3 – 2017

Current Developments: *SEC and Financial Reporting Developments* Q3 – 2017

As of January 1, 2017, calendar year-end public companies will need to adopt several standards intended to simplify or clarify accounting requirements as follows:

- *Simplifying the measurement of inventory* (ASU 2015-11)
- *Presentation of deferred taxes as noncurrent* (ASU 2015-17)
- *Effect of derivative contract novations on existing hedge accounting relationships* (ASU 2016-05)
- *Contingent put and call options in debt instruments* (ASU 2016-06)
- *Simplifying the transition to the equity method of accounting* (ASU 2016-07)
- *Improvements to employee share-based payment accounting* (ASU 2016-09)

- *Consideration of interests held through related parties under common control* (ASU 2016-17)
- *Technical corrections* (December 2016) (ASU 2016-19)
- *Amendments to SEC paragraphs pursuant to staff announcements at EITF meetings* (ASU 2017-03)

For a summary of these amendments and a listing of the standards effective in 2017, refer to *Focus on financial reporting 2016* and *Current Developments: US – Q1 2017*.

New guidance in 2017 and reminders on major standards

The following are new accounting standards affecting public business entities and reminders on revenue recognition, financial instruments and leases.

FASB and SEC Updates for Revenue (ASC Topic 606)

FASB updates

In the prior year, the FASB had issued three additional amendments to the revenue standard to clarify certain aspects of Topic 606 *Revenue from Contracts with Customers* without changing the core principles. In 2017, the FASB issued one new standard, *Identifying the Customer in a Service Concession Arrangement,* which has allowed companies to focus on the implementation of the new revenue standard and the transition requirements.

Identifying the customer in a service concession arrangement – In May 2017, the FASB issued a new standard clarifying that the customer in a service concession arrangement, such as those arrangements between a grantor and an operator for the operation and maintenance of the grantor's hospital, is always the grantor (e.g. the government or public sector entity that owns the public infrastructure). Third party users, such as the patients, are not customers. The identification of the customer affects revenue recognition and other aspects of the accounting for these arrangements.

The standard is effective concurrent with the Topic 606.

SEC observations and updates

Revenue recognition implementation has been a key focus area of the SEC staff and observations from consultations with registrants have brought up common themes that may be a challenge. These themes include:

- *Identifying the contract:* an assessment of the specific facts and circumstances of each transaction, including all relevant contractual terms, and the use of judgement is required when identifying and evaluating each contract with its customers. Determining the contract with the customer is a critical step that requires evaluating enforceable rights and obligations. An analysis of contractual provisions such as termination clauses and repurchase rights could affect the accounting conclusions related to a contract.
- *Identifying performance obligation:* it should not be presumed that the concept of a 'deliverable' under current guidance is the same as the concept of a 'performance obligation' under the new standard. Although conclusions about the unit of account may not change, an evaluation of the contractual terms of its customers under the new standard is required to reach this conclusion. The identification of the performance obligation requires the application of judgement and must be supported by the core principles of the standard.

Additionally, there has been a significant amount of discussion about the disclosure requirements, related not only to the transition disclosures (refer to introduction) but also to the new disclosure requirements in the standard. Challenging new disclosure areas include:

- disaggregating revenue into categories that depict how the nature, amount, timing and uncertainty of cash flows are affected by economic factors; and
- how the transaction price is allocated to the remaining performance obligations.

The new disclosure requirements may require updates and/or implementation of systems, processes and controls to capture the information needed.

The SEC staff also provided relief to certain public business entities from having to adopt the revenue standard on January 1, 2018 (see SEC regulatory guidance) and commented on a practice issue related to the accounting for pre-production costs and customer reimbursements. The SEC also issued two releases (a) Bill-and-hold arrangements and b) Vaccine stockpiles) and Staff Accounting Bulletin 116, (which modifies other SAB Topics to conform existing SEC staff guidance to the revenue standard) to update certain interpretive guidance about revenue recognition to conform to the new standard.

For more information on revenue refer to *Current Developments: US – Q1, Q2*, and *Q3 2017*.

Clarified Scope of ASC 610-20 for Nonfinancial Assets

The FASB issued a new standard that clarifies the guidance in ASC 610-20 about the accounting for derecognition of a non-financial asset and an in-substance non-financial asset. Specifically, the guidance in ASC 610-20 will apply only when the asset (or asset group):

- does not meet the definition of a business; and
- is not a not-for-profit entity.

The amendments define an 'in-substance non-financial asset' as a financial asset (e.g., receivable) included in a contract, or consolidated subsidiary, in which substantially all of the fair value (excluding cash and cash equivalents) is concentrated in non-financial assets. The standard also includes guidance about partial sales of non-financial assets.

The amendments are effective concurrent with the new revenue standard. At adoption, a company also must apply the FASB's new definition of a business to determine which transactions are in the scope of the new standard. However, a company need not revisit its existing allocation to goodwill if it changes its conclusions about whether a transferred group of assets is a business.

Financial Instruments

Effective date nears for recognition and measurement standard

The FASB's standard about recognition and measurement of financial assets and financial liabilities will be effective for annual and interim periods beginning on or after December 15, 2017 for public business entities.

The most significant operational changes likely will relate to the new guidance for investments in equity securities that currently apply the cost method because the fair value is not readily determinable. Under the new standard, companies can elect to measure these equity securities at fair value, or use a new measurement alternative – cost basis adjusted for observable transaction prices – that adjusts the cost basis for impairment and transaction prices observed for identical or similar securities of the same issuer. This new measurement alternative has been the source of the greatest number of interpretive questions about the new standard, and will likely require the most significant changes to processes and controls.

Companies that elect to apply the new measurement alternative should ensure that appropriate processes and controls will be in place to:

- determine which securities of the same issuer are considered to be similar;
- search for observable transactions of identical or similar securities; and
- determine how the transaction price of a similar, but not identical, security should be adjusted to reflect differences in rights and obligations.

The standard also requires that equity securities that have a readily determinable fair value be measured at fair value with changes recognized in net income. Additionally, the standard includes guidance for related deferred tax assets, fair value disclosures and financial liabilities that apply the fair value option.

New hedge accounting standard

The FASB issued a new standard that allows companies to better align their hedge accounting and risk management activities, and potentially reduce the cost and complexity of applying hedge accounting.

The standard requires companies to change the recognition and presentation of the effects of hedge accounting by:

- eliminating the requirement to separately measure and report hedge ineffectiveness; and
- requiring companies to present all of the elements of hedge accounting that affect earnings in the same income statement line as the hedged item.

The standard also permits hedge accounting for strategies for which hedge accounting is not permitted today, and includes new alternatives for measuring the hedged item for fair value hedges of interest rate risk. Furthermore, the standard eases the requirements for effectiveness testing, hedge documentation and applying the critical terms match method and introduces new alternatives that will permit companies to reduce the risk of material error corrections if they misapply the shortcut method.

The standard is effective for public business entities for annual and interim periods beginning after December 15, 2018, and for all other entities for annual periods beginning on or after December 15, 2019, and interim periods after December 15, 2020.

Measuring credit impairment

The FASB's new credit impairment standard will be effective for annual and interim periods in fiscal years beginning after December 15, 2019 for SEC filers and December 15, 2020 for Non-SEC filers. Companies should be analyzing the implications of adopting this standard and considering the adequacy of their disclosures about the expected effects of adoption.

The FASB's overhaul of credit impairment accounting will significantly affect financial institutions and other companies that originate or invest in financial assets such as loans, receivables and debt securities measured at amortized cost. The new current expected credit loss model will require companies to recognize an estimate of credit losses expected to occur over the remaining life of the financial assets, including estimating future economic conditions and the affect those conditions will have on expected credit losses.

Although the standard is not effective until 2020, those companies that will be most affected by its requirements should be making significant progress toward adoption. The nature and extent of preparations will vary, but companies will need to thoroughly evaluate the effect of the standard and determine what changes will be necessary. Companies may need to collect more data, and significantly change their systems, processes and internal controls to comply with the standard.

For more information on financial instruments refer to *Current Developments: US – Q3 2017*.

Leases

The leases standard will be effective for public companies for annual and interim periods beginning after December 15, 2018, and one year later for all other entities. By now, most companies understand that the new lease accounting standard will require lessees to recognize all leases (except for short-term leases) on the balance sheet. Companies should be focusing on their implementation plans, including identifying their population of leases, and deciding how to transition (e.g. whether to elect the transition practical expedients) and what policy elections to make for their ongoing lease accounting (e.g. as a lessee, whether to separate lease from non-lease components for different classes of underlying assets and whether to elect the short-term lease recognition and measurement exemption).

Companies may be surprised at the effort needed to transition to the new leases standard, especially with respect to the initial steps of compiling an inventory of leases as the database of leases may not be complete. Additionally, feedback has indicated that companies may identify a number of leases that are implicit in non-lease contracts, such as IT service contracts and dedicated supply agreements).

In addition to the significant effort required to identify and abstract leases, companies should take stock of other provisions that will likely significantly affect the implementation efforts and subsequent accounting, such as:

- reassessment of lease term or lessee purchase options for significant events or changes in circumstances within the control of the lessee occur;

- remeasurement of a lease whenever the market value of an underlying asset subject to residual value guarantee substantively changes or a contractual payment contingency is resolved; and
- foreign currency matters for operating leases with respect to the rate used to measure the portion of the leased cost associated with the amortization of the right of use asset (non-monetary) and the rate for the portion of the lease cost associated with the accretion of the lease liability (monetary).

To facilitate periodic reassessments and accommodate the changes to foreign exchange calculations companies may need to update or implement new systems. Additionally, companies need to carefully revisit and revise their internal controls and processes to address the transition and ongoing reporting requirements of the new guidance.

The FASB will propose amendments to the leases standard to address certain implementation issues raised by stakeholders. These amendments include approximately 20 technical corrections to the leases guidance and a new transition practical expedient related to the accounting for land easements. The technical corrections are not intended to change the principles of the standard and will be narrowly focused.

To simplify the accounting for leases the FASB has provided a policy election for lessees. Under this election lessees will have the option to not separate lease from non-lease components (e.g. common area maintenance, equipment maintenance and operations services) for new leases that commence on or after the effective date of the standard. The policy election will be available by class of underlying asset (e.g. retail space, automobiles, or office equipment) and not on a lease-by-lease basis or based on the payment terms of the lease (i.e. gross versus net).

For more information refer to *Current Developments: US – Q1, Q2 and Q3 2017*.

Simplified Goodwill Impairment Test

The FASB issued a new standard to reduce the cost and complexity of accounting for goodwill. The new standard:

- *Eliminates Step 2 of the goodwill impairment test:* Companies will no longer be required to perform a hypothetical purchase price allocation to measure goodwill impairment. Instead, they will measure impairment as the difference between the carrying amount and the fair value of the reporting unit.
- *Replaces the qualitative assessment:* Companies will no longer perform a qualitative assessment for reporting units with zero or negative carrying amounts. Instead, they will disclose the amount of goodwill allocated to each reporting unit with zero or negative carrying amounts, and disclose in which reportable segment the reporting unit is included.

The standard is effective for public business SEC filers for annual and interim periods beginning after December 15, 2019, for public business entities that are Non-Sec filers December 15, 2020 and for all others, December 15, 2021. All companies may early adopt the standard for goodwill impairment tests with measurement dates on or after January 1, 2017.

For more information including the transition for other business entities refer to *Current Developments: US – Q1 2017 and Q2 2017.*

New Definition of a Business

The FASB released a new framework for determining whether transactions should be accounted for as acquisitions (or disposals) of a group of assets or a business. As a result of adopting the new standard, fewer transactions are expected to involve acquiring or selling a business. The real estate and life sciences industries likely will be most affected.

The new framework includes an initial screening test that reduces the population of transactions an entity needs to analyze to determine whether an integrated set of activities and assets includes an input and a substantive process. The screening test states that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. The amendments also provide a framework to assist entities in evaluating whether both an input and a substantive process are present.

The standard is effective for public business entities for annual and interim periods beginning after December 15, 2017. For all other entities, the standard is effective for annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019.

For more information including the transition for other business entities refer to *Current Developments: US – Q1 2017.*

Other New Standards and Guidance

The following are other new accounting standards issued in 2017 affecting public business entities in 2018 and beyond. The potential effects of these standards may need to be disclosed in the annual 2017 financial statements.

Effective for public business entities for annual and interim periods after December 15, 2017:

- *Recognition of breakage for certain prepaid stored-value products* (ASU 2016-04);
- *Statement of cash flows – classification of certain cash receipts and payments* (ASU 2016-15);
- *Accounting for income taxes on intercompany transfers* (ASU 2016-16);
- *Changes to VIE primary beneficiary test* (ASU 2016-17);
- *Statement of cash flows – presentation of restricted cash* (ASU 2016-18);
- *Improving the presentation of net periodic pension cost and net periodic postretirement benefit cost* (ASU 2017-07);
- *Modification accounting in share-based payment awards* (ASU 2017-09). For more information refer to *Current Developments: US – Q3 2017*.

Effective for public business entities for annual and interim periods after December 15, 2018 and beyond:

- *Shortened premium amortization for purchased non-contingently callable debt securities* (ASU 2017-08), and
- *Accounting for certain financial instruments with down round feature* (ASU 2017-11).

For more information, refer to the Appendix in *Current Developments: US – Q3 2017*.

FASB Projects

Insurance Contracts

The FASB continues to redeliberate comments received on its proposed accounting standard that would change how insurance entities recognize, measure, present and disclose long-duration insurance contracts.

The proposed guidance would apply to only those insurance entities within the scope of US GAAP guidance related to insurance contracts (ASC 944). It would exclude holders of insurance contracts and contracts issued by non-insurance entities.

The proposed amendments to long-duration insurance contracts primarily address the following:

- the liability for future policy benefits;
- contracts with market-risk benefits;
- deferred acquisition costs; and
- disclosures.

For more information refer to *Current Developments: US - Q3 2017*.

Simplified Debt Classification

The FASB recently proposed changes to simplify the guidance about when debt should be classified as current on the balance sheet. The proposal would replace the existing rules-based guidance with a principles-based approach that considers a company's facts and circumstances as of the balance sheet date.

The proposals would likely cause more debt arrangements to be classified as current liabilities than under current US GAAP. Current US GAAP allows a company to classify its short-term debt as non-current if it can demonstrate its intent and ability to refinance the debt on a long-term basis after the balance sheet date but before the financial statements are issued (or available to be issued). The proposal would eliminate this provision. Therefore, a company would classify all short-term debt as current regardless of its intent to refinance.

For more information refer to *Current Developments: US – Q1 2017*.

Aligning Non-employee and Employee Share-based Payment Accounting

As part of its simplification initiative, the FASB proposed guidance that would generally align the accounting for non-employee and employee share-based payments, including:

- the overall measurement objective of share-based payment accounting,
- the measurement date for equity-classified awards,
- the accounting for awards with performance conditions, and
- subsequent measurement.

The FASB concluded that there is no substantive difference between share-based payments awarded to non-employees and employees because both types of awards are economically similar.

For more information refer to *Current Developments: US – Q1 2017*.

Other Projects

Other projects that are on the FASB agenda and in discussion with the Emerging Issues Task Force (EITF) include:

- Additional inventory disclosures – part of the broader disclosure framework project;
- Potential reorganization of consolidation guidance;
- Targeted improvements to related party guidance for variable interest entities;
- Proposed clarifications for accounting for grants and similar transactions;
- Proposed technical corrections and improvements to eliminate outdated special income tax accounting guidance for steamship entities and certain depository and lending institutions;
- EITF addresses costs incurred in certain cloud computing arrangements.

For more on the above projects refer to *Current Developments: US – Q1 2017* or *US – Q3 2017*.

Regulatory Guidance and Other Activities

SEC Staff Focus Areas

Non-GAAP financial measures and Internal Control Over Financial Reporting (ICOFR)

The SEC staff continue to focus on non-GAAP financial measures and internal control over financial reporting. They have continued to observe non-compliance with SEC's *Compliance & Disclosure Interpretations* (C&DIs), released in May 2016. Some of the areas in which registrants have received comments include:

- presentation of non-GAAP financial measures more prominently than GAAP measures;
- providing potentially misleading financial measures by, for example, excluding normal operating expenses, computing the measures inconsistently between periods, including gains, but excluding charges, or tailoring individual accounting principles;
- disclosing per share non-GAAP liquidity measures (which are prohibited); and
- presenting earnings before interest and taxes; earnings before interest, taxes, depreciation, and amortization; or free cash flow without reconciling it to a GAAP measure.

SEC comment letters on registrants' assessments of ICOFR and disclosures in periodic SEC filings have included comments on:

- failure to disclose material changes to ICOFR;
- immaterial error corrections;
- inadequate description of control failures, including insufficient detail about (1) the nature of the material weakness and its effect on financial reporting and internal control and (2) management's remediation plans;
- inconsistency between conclusions;
- inadequate disclosures about remediation status of a previously identified material weakness; and
- administrative deficiencies.

For more information on SEC staff comments on Non-GAAP financial measures and internal controls over financial reporting as well as other focus areas refer to *Current Developments: US – Q1 and Q2 2017*.

SEC Staff Effective Date Relief for Certain Public Business Entities

The SEC staff announced that it will not object if certain public business entities (PBEs) use private company adoption dates for the new revenue and leases standards. Specifically, this relief applies to an entity that meets the definition of a PBE only because it is required to include its financial statements or financial information in another entity's filing with the SEC and otherwise would not meet the definition of a PBE. The announcement applies to only this narrow group of PBEs and is limited to the new revenue and leases standards (i.e. it does not extend to other accounting standards).

For more information refer to *Current Developments: US SEC and Financial Reporting Developments Q3 2017*.

Other Matters

Other areas of SEC amendments and focus have included:

- Amendments for requirements for exhibit hyperlinks and HTML format;
- Initiative to modernize Industry Guide 3, which generally applies to bank holding companies;
- Relief on conflict minerals;
- Rule Amendments under JOBS Act;
- Shortened settlement for securities transactions;
- XBRL requirements for foreign private issuers preparing financial statements in accordance with IFRS;
- C&DIs about Regulation A.

For more information refer to *US Q2 Current Developments*.

Private enterprises

Developments in Accounting Standards for Private Enterprises

Updates to ASPE are done through:

- major improvements, and
- annual improvements for clarifications on guidance or wording, or to correct relatively minor unintended consequences, conflicts or oversights.

New Guidance Issued

Amendments to section 1591 *subsidiaries* and section 3051 *investments*

In December 2016 the AcSB issued amendments to Section 1591 *Subsidiaries* and Section 3051 *Investments* to address the accounting for a subsidiary and an investment subject to significant influence when the cost method is used, recognizing that there has been diversity in practice in the application of the cost method.

The underlying principle of the amendments is that:

- a consistent approach should be applied to investments and interests in subsidiaries that are accounted for using the cost method; and
- the initial measurement of an interest in a subsidiary accounted for using the cost method should be on a basis similar to other business combinations, specifically as it relates to acquisition related costs, contingent consideration, pre-existing relationships and subsequent accounting for contingent consideration.

The key aspects of the amendments to subsidiaries when the cost method is used are as follows:

- initial cost would be measured at the acquisition-date fair value of the consideration transferred, including contingent consideration. Contingent consideration is re-measured when the contingency is resolved;
- acquisition-related costs are expensed as incurred;
- pre-existing relationships would be required to be separately identified and settlement of such relationships is considered a separate transaction;
- no recognition of bargain purchase gains (i.e., "negative goodwill");
- for a step acquisition, there is no re-measurement of the previously held interest. This includes where acquisition related costs have been capitalized in accordance with Section 3856 Financial Instruments. Entities would, however, be required to consider whether the cost of the additional interest acquired indicates an impairment; and
- at a reporting date, where the initial accounting is incomplete as a result of working capital adjustment clauses or other reasons, the carrying amount of the interest in the subsidiary is based on provisional amounts. Such provisional amounts are adjusted in the period they are finalized, with the measurement period not to exceed one year from the acquisition date. Adjustments to provisional amounts are not retrospectively recognized in the prior period.

The key aspects of the amendments to investments subject to significant influence when the cost method is used are as follows:

- initial cost would be measured at the acquisition-date fair value of the consideration transferred;
- acquisition-related costs are expensed as incurred; and
- for acquisitions of additional interests there is no re-measurement of the previously-held interest. This includes where acquisition-related costs have been capitalized in accordance with Section 3856 Financial Instruments. Entities would, however, be required to consider whether the cost of the additional interest acquired indicates an impairment.

The AcSB chose not to add a similar requirement to expense acquisition-related costs for investments subject to significant influence when the equity method is applied, as such a change was considered to be outside of the scope of the project.

The amendments are effective for fiscal years beginning on or after January 1, 2018, with earlier application permitted.

Narrow scope amendments to Section 1591 *subsidiaries* and section 3056 *Interests in joint arrangements*

Also in December 2016 the ACSB issued narrow scope amendments to Section 1591 *Subsidiaries* and Section 3056 *Interest in Joint Arrangements* to provide the following clarifications, which are effective for fiscal years beginning on or after January 1, 2017, with earlier application permitted:

- transitional provisions under Section 1591 and 3056 can only be applied on the initial application of the standard and may not be applied if an enterprise changes its accounting policy at any time after the initial application; and
- an enterprise preparing non-consolidated financial statements is not required to assess whether contractual arrangements give rise to control.

In addition, Section 1591 was amended to clarify the accounting where control exists as a result of a combination of voting interests and contractual arrangements and the subsidiary is not consolidated. Specifically, the amendments clarify that the voting interest is accounted for using either the cost or equity method and the contractual arrangement is accounted for in accordance with the nature of the contractual arrangement. This amendment is effective for fiscal years beginning on or after January 1, 2018.

Annual improvements

In July 2017, the AcSB released the 2017 annual improvements to ASPE, which resulted in narrow scope amendments to the following standards:

- Section 1505 *Disclosure of Accounting Policies* to require the disclosure of accounting policies be provided in one of the first notes rather than as the first note, to the financial statements;
- Section 1506 *Accounting Changes* to remove the requirement to disclose the amount of an adjustment related to an accounting policy change for the current period and instead require disclosure of the amount of the adjustment required in the prior periods presented;
- Section 1521 *Balance Sheet* to clarify presentation and disclosure requirements, including that assets under capital leases should be presented separately on the face of the balance sheet or disclosed in the notes to the financial statements;
- Section 1651 *Foreign Currency Translation* to clarify the requirements on the reversal of previous write downs as a result of foreign currency translation of assets valued at the lower of cost and market; and
- Section 3065 *Leases* clarifying that only the amount of the allowance for impairment, not the carrying amount of impaired operating lease receivables, is required to be disclosed, consistent with the requirements under Section 3856 *Financial Instruments* for current trade receivables.

These amendments are effective for years beginning on or after January 1, 2018, with earlier application permitted.

Exposure Drafts

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

Under the AcSB's exposure draft, Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement (formerly Redeemable Preferred Shares Issued in a Tax Planning Arrangement) issued in September 2017, the AcSB proposes to modify the accounting for retractable or mandatorily redeemable shares issued in a tax planning arrangement. The exposure draft proposes that the basis for an exception to liability classification for such instruments would be on the condition of retention of control of the entity by the party receiving the issued shares. Additionally, for the classification exception to apply, two other

conditions must also be met, being that no other arrangements exist that require redemption of the shares in a fixed or determinable period and that the only consideration exchanged in the transaction is shares.

Under the exposure draft, the classification exception would be applied on a retrospective basis, with an option not to restate comparatives, and classification would be based on the terms and conditions that exist at the date of initial application. For shares classified as liabilities the initial measurement would be the redemption amount, with the offset to a separate component of equity. The exposure draft would prohibit the subsequent reclassification of the shares to equity. For shares that are classified as equity, a reassessment of the classification would only be required when a subsequent event or transaction indicates that one or more of the conditions for equity classification are no longer met.

The exposure draft proposes an effective date of January 1, 2020, with the ability to early adopt.

Accounting for related party financial instruments and significant risk disclosures

The AcSB's exposure draft *Accounting for Related Party Financial Instruments and Significant Risk Disclosures – Proposed Amendments to Section 3856, Financial Instruments*, which was issued in October 2017, proposes a number of limited scope amendments to Section 3856 as a result of feedback received during the post-implementation review of Section 3856.

The limited scope amendments proposed include relocating all measurement guidance for related party financial instruments within Section 3856.

To address concerns regarding the initial and subsequent measurement of related party financial instruments the exposure draft proposes that related party financial instruments should be measured at cost, with the exception of instruments quoted in an active market and derivatives, for which fair value measurements would apply. Cost would be determined based on whether or not the financial instrument has repayment terms. For financial instruments with repayment terms, cost would be measured using the undiscounted cash flows of the instrument, excluding interest and dividend payments. For financial instruments without repayment terms, cost would be measured using the consideration transferred in the transaction.

The proposal also clarifies that an entity would be permitted to initially measure the equity component of a related party compound financial instrument at zero and that no option will be provided to elect to measure related party financial instruments at fair value.

The exposure draft also addresses impairment of related party financial assets and requires an assessment and recognition of an impairment in net income prior to the recognition of a forgiveness. An impairment or forgiveness would be recognized through net income or equity depending on whether the financial asset arose from a transaction in the normal course of operations or outside of the normal course of operations.

Under the exposure draft, the AcSB has concluded that the removal of the requirement to disclose how financial instrument risk arose would reduce the usefulness of the financial statements and therefore proposes that the current disclosure requirements remain appropriate.

The exposure draft proposes an effective date of January 1, 2020, with the ability to early adopt.

Other Projects

Agriculture

In late 2015, the AcSB issued a discussion paper on Agriculture as an initial step in addressing significant diversity in practice regarding the accounting for biological assets and agricultural produce. The discussion paper addressed when a biological asset should be recognized, how it should be measured, both initially and in subsequent periods, how agricultural produce should be accounted for and what disclosure should be required.

The AcSB followed up on the release of the discussion paper with a webinar, a series of cross country roundtables and the establishment of an Agricultural Advisory Group to obtain stakeholders' views and seek input with regards to current practice. Based on the feedback received, the AcSB subsequently approved a standards-level project to develop a new standard and they have committed to issue an exposure draft no later than the third quarter of 2018.

Key decisions communicated to date include:

- the scope should define and refer to agricultural producers and that as a result, agricultural inventories acquired by secondary processors, retailers or broker traders would continue to fall within the scope of Section 3031 *Inventories*;
- productive biological assets would be measured at cost; and
- agricultural inventories would also be measured at cost, with measurement at net realizable value as a practical expedient permitted, but not required, when certain conditions are met.

Consultation on relative priorities for part II (ASPE)

The AcSB stated in its 2017-2018 Annual Plan that it would complete consultations with stakeholders about the relative priorities of Part II. As such, the AcSB released two surveys in 2017. The first survey was designed to identify primary areas of concern with Section 3400 Revenue, "Consultation on Section 3400, Revenue, in Part II of the CPA Canada – Handbook – Accounting" which closed in May 2017. The AcSB has determined that Section 3400 is a high priority and that stakeholders have expressed a need for additional revenue recognition guidance.

The second survey was designed to obtain input on prioritizing topics the AcSB was considering, "Relative Priorities for Future Part II Projects" which closed in August 2017. Topics included in the survey included, Section 3840 *Related Party Transactions*, Section *3856 Financial Instruments*, goodwill and intangible assets on business combinations, determination of presentation currency for foreign operations, and a series of others.

The AcSB has discussed the results of this survey and has tentatively decided on three topics that should be prioritized for further research in addition to its research activities on Section 3400, subject to additional input from its Private Enterprise Advisory Committee.

Not-for-profit organizations

Accounting Standards for Not-for-profit Organizations (Part III of the CPA Canada Handbook – Accounting)

Joint Not-for-profit Review

As previously reported in our publications, the AcSB included not-for-profit organizations in its issued-for-comment draft strategic plan for 2016–2021. The proposed core strategy includes maintaining a separate set of accounting standards for areas unique to not-for-profit organizations while continuing to direct them to Part II of the *CPA Canada Handbook – Accounting* for non-unique areas (such as employee future benefits and financial instruments). The AcSB formed a not-for-profit advisory committee (the "Committee") to provide input into this process and approved a three phase project plan.

The exposure draft related to Phase 1 – Accounting Standards Improvements for Not-For-Profit Organizations was released in February 2017 with the comment period having closed on May 31, 2017. A summary of the exposure draft content includes:

Tangible capital assets:

Existing section 4431 *Tangible Capital Assets* will be replaced by a new Section 4433. Overall there will be direction to apply accounting standards for private enterprises Part II of the Handbook, except where guidance is included in Section 4433.

- Section 3061 Property, *Plant and Equipment* would be used as the guidance to report:
  - the capitalization, amortization and disposal of tangible assets – largely similar with the current practice
  - componentization for tangible capital assets – new concept for Not-For-Profit Organizations. This would entail, where practicable and when estimates can be made of the lives of the separate components, significant capital additions being accounted for on a component basis. For example, a building whereby different estimated amortization periods can be identified for the roof versus the bricks and mortar.
- Section 3110 *Asset Retirement Obligations* related to recognition, measurement and disclosure of liabilities related to long-lived assets and;
- Section 3063 *Impairment of Long-Lived Assets* for disclosure requirements related to impairment, including partial impairment, of long lived assets. Impairment adjustments will be to either fair value or replacement cost based on a list of indicators which will be provided as guidance for decision making.

Intangible capital assets:

The new section 4434 *Intangible Assets* will provide additional support and guidance related to intangible assets such as goodwill, trademarks and software. Reference is made to Section 3064 *Goodwill and Intangible Assets*, for the capitalization, amortization and disposal of such assets and Section 3063 *Impairment of Long-Lived Assets,* for impairment disclosures. Similar to tangible capital assets, the concept of partial impairment and write down decisions will be supported by a list of indicators along with transitional guidance and disclosure requirements.

Collections

It is proposed that the existing Section 4440 *Collections Held by Not-For-Profit Organizations* be replaced with a new Standard 4441, requiring minimal change, however formalizing current practice and providing for heightened consistency. The amendments will require that:

- Collections held be recorded on the Statement of Financial Position at either cost or a nominal value. Careful selection of cost or nominal value will be important as consistency in methodology will be required for all collections.
- When collections are disposed of, the difference between the carrying value and proceeds will be accounted for in accordance with S4410 *Contributions – Revenue Recognition*, if externally restricted or through the Statement of Operations if not restricted.
- Similar to Tangible Capital Assets, a partial or full write down will be required based on key indicators; the write down will be to fair value or replacement cost with the difference recorded as a charge to the Statement of Operations.
- Enhanced disclosure requirements will be included in the new section along with transition provisions. The transitional provisions are anticipated to include an election to record retrospectively at either (i) cost or fair value at the date of acquisition, or (ii) fair value or replacement cost at the date of application of the new standards.

Transitional Provisions

Overall transitional provisions are anticipated to be in accordance with Section 1506 in Part II as follows:

- Prospective application for Sections 4433 and 4434 with relief for the allocated cost of tangible capital assets to their component categorization and an adjustment to opening net assets for partial impairments at the date of application of the new standard.
- Retroactive application for Section 4441 with relief for those deciding to record collections at cost.

The AcSB has proposed an effective date for implementation for years commencing on or after January 1, 2019.

Public sector entities

Developments in Accounting Standards for Public Sector

New Guidance Issued

There was no new guidance issued in 2017.

Related Party Transactions for Not-for-profit Organizations

In December 2016, the Public Sector Accounting Board (PSAB) withdrew PS 4260, *Disclosure of related party transactions by not-for-profit organizations*, as similar disclosure requirements are provided in Section PS 2200 *Related Party Disclosures*. Section PS 4260 will remain in effect until the adoption of Section PS 2200 for fiscal periods beginning on or after April 1, 2017, unless a not-for-profit organization elects earlier adoption.

PSAB also amended the definitions of control and shared control in Section PS 4250 *Reporting controlled and related entities by not-for-profit organizations*, to conform to those provided in in Section PS 2200 *Related Party Disclosures*.

Editorial changes and clarifications were also made to other standards as a consequence of the withdrawal of Section PS 4260.

Sections PS 4260 and PS 2200 are very similar except that PS2200 does not include the concept of significant influence or economic interest. However, disclosures for significant influence and economic interest are required by Section PS 4250, *Reporting controlled and related entities by not-for-profit organizations*.

Reminders of Certain Guidance Previously Issued

As a reminder, PSAB previously issued the following sections that are effective in 2017 or future years:

Sections	Effective for fiscal years
Introduction to Public Sector Accounting Standards	Beginning on or after January 1, 2017
Related Party Disclosures, Section PS 2200	Beginning on or after April 1, 2017
Inter-entity Transactions, Section PS 3420	Beginning on or after April 1, 2017
Assets, Section PS 3210	Beginning on or after April 1, 2017
Contingent Assets, Section PS 3320	Beginning on or after April 1, 2017
Contractual Rights, Section PS 3380	Beginning on or after April 1, 2017
Restructuring Transactions, Section PS 3430	Beginning on or after April 1, 2018
Financial Instruments, Section PS 3450	Beginning on or after April 1, 2019, with early implementation for government organizations transitioning from Part V of the CPA Canada Handbook – Accounting. Early adoption is permitted.
Portfolio Investments, Section PS 3041	
Foreign Currency Translation, Section PS 2601	
Financial Statement Presentation, Section PS 1201	

PSAB Projects Underway

The following section discusses the major projects currently with PSAB:

Revenue

On May 1, 2017, PSAB issued an exposure draft for proposed Section PS 3400, *Revenue* that proposes a framework describing two categories of revenue – exchange and unilateral. The exposure draft closed for comment on August 15, 2017, and the stakeholder responses remain under review by PSAB. A final standard is expected to be released during the second quarter of 2018.

As per exposure draft, transactions which give rise to one or more performance obligations are considered to be exchange transactions. Performance obligations are defined as enforceable promises to provide goods or services to a payor as a result of exchange transactions. Revenue from an exchange transaction would be recognized when the public sector entity has satisfied the performance obligation(s), at a point in time or over a period of time. If no performance obligations are present, the transaction would represent unilateral revenue, and be recognized when the public sector entity has the authority to claim or retain an inflow of economic resources and a past event gives rise to a claim of economic resources.

The proposed new section would apply to fiscal years beginning on or after April 1, 2021, and be accounted for as a change in accounting policy applied retroactively with restatement of prior periods.

Retirement Obligations

On March 9, 2017, PSAB issued an exposure draft for proposed Section PS 3280 *Asset Retirement Obligations*. The proposed new standard would address the reporting of legal obligations associated with the retirement of certain tangible capital assets and solid waste landfill sites by public sector entities. The exposure draft proposes to withdraw existing Section PS 3270 *Solid Waste Landfill Closure and Post-Closure Liability*. The exposure draft closed for comment on June 15, 2017, and the stakeholder responses remain under review by PSAB. A final standard is expected to be released during the second quarter of 2018.

The exposure draft proposes similar accounting for asset retirement obligations as within Part V of the *Handbook*. An asset retirement obligation would be recognized when, as at the financial reporting date, all of the following criteria are met:

- there is a legal obligation to incur retirement costs in relation to a tangible capital asset;
- the past transaction or event giving rise to the liability has occurred;
- it is expected that future economic benefits will be given up; and
- a reasonable estimate of the amount can be made.

Public sector entities would be required to capitalize asset retirement obligations associated with fully amortized tangible capital assets, except in the following instances:

- asset retirement obligations associated with unrecognized tangible capital assets should be expensed;
- asset retirement obligations associated with tangible capital assets no longer in productive use should be expensed.

The estimate of a liability should include costs directly attributable to asset retirement activities.

The new Section would apply to fiscal years beginning on or after April 1, 2021. Earlier adoption would be permitted. This Section would be applied retroactively or prospectively. If retroactive application is elected, a public sector entity would be able to choose to apply certain transitional provisions provided in the Section.

Employment Benefits

PSAB has approved a project to review Sections PS 3250 *Retirement benefits* and PS 3255 *Post-retirement benefits* as a result of significant changes in types of pension plans and related accounting concepts. The project has been divided into two phases. The first phase will review measurement issues such as deferral of experience gains and losses and the discount rate. The second phase will involve the

accounting for new types of plans, including shared risk plans. Phase two will also include consideration on accounting for multi-employer defined benefit plans and vested sick leave benefits.

In November 2016 the first invitation to comment was released regarding a review of the deferral provisions in PS 3250 and PS 3255. That invitation to comment closed for feedback in March 2017.

In September 2017, PSAB approved the second invitation to comment, *Employment Benefits: Discount Rate Guidance in Section PS 3250*, for release in November 2017.

Concepts Underlying Financial Performance

The objective of this project is to review and amend, if necessary, the conceptual framework in Sections PS 1000 *Financial Statement Concepts* and PS 1100 *Financial Statement Objectives*. This project will consider the concepts underlying the measure of financial performance and could also affect Section PS 1201 *Financial Statement Presentation*. PSAB anticipates releasing a Statement of Principles based on its previous consultation papers, during the second quarter of 2018.

Review of International Strategy

As identified in the 2017-2020 Strategic Plan, PSAB is undertaking a review of its current international strategy of influencing the International Public Sector Accounting Standards Board (IPSASB). PSAB has identified four options with respect to this strategy:

- continue to apply Public Sector Accounting Standards as enacted;
- develop future Public Sector Accounting Standards based on International Public Sector Accounting Standards;
- apply International Public Sector Accounting Standards by exception; or
- apply International Public Sector Accounting Standards as issued by IPSASB.

A consultation paper is expected to be released by PSAB during the second quarter of 2018.

Public Private Partnerships

The public private partnerships task force was established to assist PSAB in developing authoritative guidance specific to public private partnerships. The project will include two phases. The first phase will relate to specific issues, including project scope, recognition and measurement of public private partnerships and disclosure requirements. The second phase will focus on the accounting for public private partnerships.

On July 20, 2017, PSAB issued a Statement of Principles that proposed a new standard on public private partnerships which closed for comment October 17, 2017. PSAB is currently deliberating stakeholder feedback, and anticipates releasing an exposure draft in the second quarter of 2018.

Financial Instruments – Subsequent Issues

PSAB continued to hold consultations across the country in 2017 to obtain a better understanding of issues with implementation of Sections PS 2601 *Foreign currency translation* and PS 3450 *Financial instruments*. PSAB continues to discuss the technical issues identified in the consultations. During 2017 PSAB also considered IPSASB's Exposure Draft 62 *Financial Instruments* and continued outreach to stakeholders to promote understanding of the IPSASB's proposals.

Appendix

Acronyms

AcSB	Accounting Standards Board
ASPE	Accounting Standards for Private Enterprises
CPA	Chartered Professional Accountant
CPAB	Canadian Public Accountability Board
CSA	Canadian Securities Administrators
CSM	Contractual Service Margin
EBITDA	Earnings before interest, taxes, depreciation, and amortization
ECL	Expected Credit Loss
EIR	Effective Interest Rate
EITF	Emerging Issues Task Force
FASB	Financial Accounting Standards Board (US)
FPI	Foreign Private Issuer
FVTPL	Fair Value Through Profit or Loss
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee, now known as the IFRS Interpretations Committee
IFRS	International Financial Reporting Standards
ICOFR	Internal Control over Financial Reporting
ICO	Initial Coin Offerings
IPSASB	International Public Sector Accounting Standards Board
ITO	Initial Token Offerings
MD&A	Management's Discussion and Analysis
NI	National Instrument
NPO	Not-for-profit Organization
OCI	Other Comprehensive Income
OSC	Ontario Securities Commission
PBE	Public Business Entity
PCAOB	Public Company Accounting Oversight Board
PS	Public Sector
PSA	Public Sector Accounting
PSAB	Public Sector Accounting Board
SEC	Securities Exchange Commission
SPPI	Solely Payments of Principal and Interest
SEDAR	System for Electronic Document Analysis and Retrieval
SN	Staff Notice
US	United States

Websites

AICPA	www.aicpa.org
ASC	www.albertasecurities.com
FASB	www.fasb.org
IASB	www.iasb.org
KPMG	www.kpmg.ca
OSC	www.osc.gov.on.ca
SEC	www.sec.gov
PSAB	www.frascanada.ca

Focus on financial reporting

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