

Clarifications to Sections 1591 and 3056 — Background Information and Basis for Conclusions

Foreword

In December 2016, the Accounting Standards Board (AcSB) released narrow-scope improvements to SUBSIDIARIES, Section 1591, and INTERESTS IN JOINT ARRANGEMENTS, Section 3056 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for the amendments.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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INTRODUCTION

- 1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching their conclusions to amend SUBSIDIARIES, Section 1591, and INTERESTS IN JOINT ARRANGEMENTS, Section 3056 in Part II of the CPA Canada Handbook – Accounting. This document sets out the reasons the AcSB undertook the project to clarify the standards, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.
- 2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the amendments and the AcSB's intent with respect to their interpretation and application.

BACKGROUND

- 3 Accounting standards for private enterprises are changed periodically through different processes, ranging from major improvements to narrow-scope improvements. Major improvements result in significant changes to accounting standards for private enterprises and narrow-scope improvements are for the purposes of implementation and maintenance of the standards. These clarifications are a type of narrow-scope improvement.
- 4 A narrow-scope improvement amends accounting standards for private enterprises to clarify the wording in a standard or correct relatively minor unintended consequences, oversights or conflicts. Such amendments do not propose a new principle or a change to an existing principle.

- 5 The AcSB released an Exposure Draft, "Clarifications to Sections 1591 and 3056," in May 2016. The proposed amendments were in response to issues submitted to the AcSB by stakeholders. In developing the proposals, the AcSB considered input from its Private Enterprise Advisory Committee.
- 6 Responses received were primarily from public accounting firms. Respondents generally expressed agreement with the proposals set out in the Exposure Draft. Given the nature of the comments received, advice was not sought from the full Advisory Committee on the comments received. Rather, a few members of the Advisory Committee were consulted on specific comments.
- 7 The issues addressed in this project, including substantive comments received on the Exposure Draft and any changes made in response to those comments, are as follows.

SUBSIDIARIES

Transitional provisions

- 8 Prior to being amended, the transitional provisions in Section 1591 were being interpreted by some to mean that the provisions may be applied when an enterprise changed its accounting policy choice to consolidation, as permitted by ACCOUNTING CHANGES, Section 1506, at any time in the future. However, the transitional provisions were developed for application only on transition to the new standard and when an enterprise prepares its first financial statements using accounting standards for private enterprises. The transitional relief was provided:
- (a) to encourage enterprises using the cost method to consolidate their subsidiaries; and
 - (b) for enterprises preparing consolidated financial statements that may identify additional subsidiaries not previously consolidated.
- 9 The Exposure Draft proposed an amendment to clarify that the transitional provisions may not be applied when an enterprise changes its accounting policy choice to consolidate its subsidiaries at any time after initial application of Section 1591.
- 10 The majority of respondents agreed with the clarification. However, three respondents suggested that, in order to encourage enterprises to consolidate their subsidiaries, the transitional relief should be available in future years as well. The AcSB considered this suggestion, including the recommendations of its Advisory Committee, during the development of Section 1591 in September 2012. The AcSB reaffirmed its decision that the transitional provisions may not be applied in future years, noting that other enterprises are preparing consolidated financial statements on a retrospective basis.
- 11 Accordingly, the AcSB approved the amendments as exposed, with some minor editorial changes.

Assessing contractual arrangements for control

- 12 Prior to being amended, Section 1591 did not explicitly state that enterprises preparing non-consolidated financial statements are not required to assess contractual arrangements for control. The AcSB noted that ACCOUNTING GUIDELINE AcG-15, Consolidation of Variable Interest Entities, which was replaced by Section 1591, was explicit in this regard. The Exposure Draft proposed an amendment to clarify that an enterprise is not required to assess whether contractual arrangements give rise to control when subsidiaries are not consolidated.
- 13 Respondents were unanimous in their agreement with this proposal. One respondent proposed specifying that the choice not to consolidate was made in accordance with paragraph 1591.24(b). The AcSB agreed to make this change. Accordingly, the AcSB approved the amendments as exposed, subject to this drafting revision.

Accounting for voting interests

- 14 Prior to being amended, Section 1591 was unclear as to how the voting interest, if any, that an investor holds in a subsidiary controlled through contractual arrangements should be accounted for when applying paragraph 1591.24(b)(ii). Some stakeholders and one respondent to the AcSB's Exposure Draft, "Subsidiaries and Investments," thought that it was unclear whether the voting interest should be accounted for in accordance with the applicable Section (i.e., FINANCIAL INSTRUMENTS, Section 3856, or INVESTMENTS, Section 3051) or in accordance with paragraph 1591.24(b)(i) (i.e., using the cost or equity method). The Exposure Draft proposed an amendment to clarify that the voting interest, if any, that an investor holds in a subsidiary is accounted for using paragraph 1591.24(b)(i) when subsidiaries are not consolidated.
- 15 Respondents generally agreed with the proposed amendment. However, one respondent noted that it was not clear whether the accounting policy choice in paragraph 1591.24(b) was to be applied consistently, or on an investment-by-investment basis, which could lead to different accounting outcomes for voting interests. The requirement to account for all subsidiaries using the same method is contained in paragraph 1591.25. However, this paragraph relates to enterprises choosing between the cost or equity method. Consequently, the AcSB decided to amend paragraphs 1591.24-.25 to clarify that the accounting policy choice provided in paragraph 1591.24(b) is to be applied consistently to all subsidiaries.
- 16 Another respondent commented that there appears to be an overlap in the scope of Section 1591 and FINANCIAL INSTRUMENTS, Section 3856, with regard to accounting for potential voting interests, and that it is unclear how potential voting interests would be accounted for using the equity method. The AcSB noted that private enterprises are directed to INVESTMENTS, Section 3051, for guidance on the equity method. In addition, the AcSB decided that the

comment raised to clarify the application of the equity method is outside the scope of these narrow-scope improvements. The AcSB will consider whether to address it after consulting its Advisory Committee. Accordingly, the AcSB approved the amendments as exposed, subject to the drafting revision described in paragraph 15.

INTERESTS IN JOINT ARRANGEMENTS

Transitional provisions

- 17 Prior to being amended, the transitional provisions of Section 3056 were unclear as to whether they are to provide relief only on transition to the new standard and when an enterprise prepares its first financial statements using accounting standards for private enterprises. The Exposure Draft proposed an amendment to clarify that the transitional provisions may not be applied when an enterprise changes its accounting policy choice, as permitted by paragraph 3056.29, at any time after initial application of Section 3056.
- 18 Respondents unanimously agreed with the proposed amendment.
- 19 One respondent suggested that the inclusion of "annual" in paragraph 3056.43B is unnecessary and could preclude an enterprise from taking advantage of the transitional provisions should they prepare interim financial statements in the year of adoption of Section 3056. The AcSB had previously considered the inclusion of "annual" in Sections 1591 and 3056, and concluded that the existing wording is consistent with other Sections in Part II, and that considering such a change would be outside the scope of these amendments. The AcSB decided not to address this concern. Accordingly, the AcSB approved the amendments as exposed, with some minor editorial changes.

OTHER ISSUES

- 20 One respondent noted that Section 1591 does not specify whether the date on which control is assessed is the effective date or at the beginning of the fiscal year immediately preceding the date Section 1591 is adopted. The AcSB agreed to clarify that an enterprise assesses control on the date at which Section 1591 is first effective.
- 21 One respondent suggested that it would be helpful to clarify that enterprises that prepare non-consolidated financial statements are not required to perform an assessment under RELATED PARTY TRANSACTIONS, Section 3840, to identify enterprises controlled through means other than voting interests. The AcSB thinks that the addition of new paragraph 1591.23A sufficiently clarifies that enterprises that prepare non-consolidated financial statements are not required to perform an assessment to identify enterprises controlled through means other than voting interests. Consequently, the AcSB decided that further clarification was unnecessary.
- 22 Another respondent recommended that the wording in ACCOUNTING CHANGES, Section 1506, and Section 1591 should be clarified to permit enterprises to change between the equity and cost method without meeting the criterion in paragraph 1506.06(b). The AcSB noted that paragraph 1591.25 permits enterprises to change between the equity and cost method without meeting the criterion in paragraph 1506.06(b) and decided that further clarification is unnecessary.
- 23 Some respondents noted other issues that should be considered as possible improvements to accounting standards for private enterprises. The AcSB noted those issues and will consider whether to address them after consultation with its Advisory Committee.

EFFECTIVE DATE

- 24 The Exposure Draft noted that the AcSB planned to issue the amendments in the fourth quarter of 2016, if no significant changes were required to the proposals after deliberating the comments received. In that case, the Exposure Draft noted that the effective date of the amendments would be for fiscal years beginning on or after January 1, 2017, with earlier application permitted. The Board finalized the effective date as proposed in the Exposure Draft for the amendments to clarify that:
- (a) the transitional provisions may not be applied when an enterprise changes its accounting policy choice to consolidate its subsidiaries at any time in the future; and
 - (b) an enterprise preparing non-consolidated financial statements is not required to assess whether contractual arrangements give rise to control.
- 25 However, the AcSB decided that the amendments to clarify the accounting for a subsidiary controlled through a combination of contractual arrangements and voting interests are effective for fiscal years beginning on or after January 1, 2018. This timing coincides with the effective date of amendments to be issued as a result of the Exposure Draft, "Subsidiaries and Investments," issued in September 2015.

