

Cash Distributions — Amendments to Section 1540

Background Information and Basis for Conclusions

Foreword

The pre-changeover standards in Part V of the CPA Canada Handbook – Accounting, which included this Basis for Conclusions document, have been removed from the Handbook. This Basis for Conclusions was developed to accompany amendments to the pre-changeover standard, but that standard was not fully converged with Part II of the Handbook. The significant difference is that in Part II, all enterprises must provide a cash flow statement, whereas in Part V it was only required by public enterprises.

Background Information and Basis for Conclusions documents are primary sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100. 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 the conclusions in amending CASH FLOW STATEMENTS, Section 1540. It sets out the reasons the AcSB undertook the project to develop these amendments, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the position taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.
- 2 Nothing in this summary is to be taken as overriding the requirements of the CICA Handbook – Accounting. However, the discussion may help readers understand how the AcSB reached its conclusions in developing amendments to Section 1540, and the AcSB's intent with respect to their interpretation and application.

BACKGROUND

- 3 Prior to amendment, paragraph 1540.55 required disclosures in respect of the terms and conditions of, and actual determination of, cash distributions that an enterprise may be required to make. As a result of monitoring financial reporting issues related to cash distributions, specifically distributions made by income trusts, the AcSB noted that many enterprises were not providing the disclosures pursuant to paragraph 1540.55. Upon closer inspection, the AcSB concluded that this was due to the specific wording of the paragraph. In the context of income trusts, since there is discretion regarding the payment of distributions, they are not "required" and accordingly, many enterprises were not providing these disclosures.
- 4 The AcSB received several requests to modify GAAP in respect of income trusts and discussed these requests extensively. The Board noted that accounting standards cannot address concerns about non-financial statement disclosures, such as determining distributable cash and the distinction between returns of capital and returns on capital when reporting yields. The AcSB does not provide standards for such non-GAAP measures. The AcSB did note that several other

organizations, including the Canadian Securities Administrators and the Canadian Performance Reporting Board, are working towards improving the Management Discussion and Analysis (MD&A) reporting in respect of these non-GAAP measures.

PROCESS

- 5 Cash distributions of income trusts and other forms of business enterprise are a GAAP amount reported in the cash flow statement. The AcSB decided that requiring disclosure of information about cash distributions on financial instruments classified as equity when the distribution is determined in accordance with a contractual agreement, would provide relevant and useful information to financial statement users, while not imposing significant costs on preparers. Accordingly, it agreed to amend paragraph 1540.55 to require disclosures for all such cash distributions, regardless of the degree of discretion in determining the distribution. An Exposure Draft proposing the amendments was issued in November 2006.
- 6 The AcSB received five letters commenting on its Exposure Draft proposals. Responses were received from financial statement preparers, users, and public practitioners. One respondent was opposed to the proposals on the grounds of international convergence, noting that the Exposure Draft proposals add literature to Canadian GAAP that does not exist in International Financial Reporting Standards (IFRS). The respondent pointed out that this would create additional transitional issues as the AcSB executes its strategy to adopt IFRS. The AcSB did not find that argument convincing; the disclosure would not be difficult to make, nor would elimination of it on adoption of IFRS. In addition, the Board did not believe that the disclosure would entail significant costs or systems changes. The Board also noted that it had not yet considered the circumstances, if any, under which it might require disclosure in addition to those in IFRSs.
- 7 One respondent, based on a concern of consistent application and compliance, noted that the text of paragraph 1540.55 should be amended to specifically refer to relevant constating documents (for example, a deed or declaration pursuant to establishing a trust). The AcSB agreed with these arguments and amended the wording of the proposed paragraph 1540.55 accordingly.

DISCLOSURE OF CASH DISTRIBUTIONS

- 8 The amended paragraph 1540.55 requires enterprises to disclose:
 - (a) the terms and conditions that apply to the determination of the cash distribution;
 - (b) the total cash distribution; and
 - (c) the extent to which the distribution is non-discretionary.The AcSB views the extent of the discretion available to the enterprise in determining the cash distribution as important information for financial statement users, as it allows them to better understand the distribution they receive in the current period and the volatility of distributions.
- 9 The AcSB agreed to remove the previous requirement in paragraph 1540.55 to disclose the actual determination of the cash distribution. This determination usually includes several elements that are subject to significant management discretion and are non-GAAP in nature. Disclosure of the actual computation of the distribution is more appropriate in MD&A than in financial statements.

DIFFERENTIAL REPORTING

- 10 The amendments to Section 1540 have been reviewed by the Differential Reporting Advisory Committee. The Committee did not believe that the amendments were overly burdensome for non-publicly accountable enterprises. The AcSB agreed with the Committees' assessment. In addition, all respondents to the Exposure Draft agreed that the proposals are appropriate for non-publicly accountable enterprises.
- 11 The disclosure requirements of the amended paragraph 1540.55 are applicable to all enterprises required to make cash distributions in accordance with a contractual agreement or relevant constating documents, not just to income trusts. The AcSB focused on the substance of the transaction rather than the type of enterprise undertaking it.

TRANSITIONAL PROVISIONS

- 12 The amended paragraph 1540.55 is effective for interim and annual financial statements for fiscal periods ending on or after March 31, 2007, with earlier application encouraged.