2015 Annual Improvements to Accounting Standards for Private Enterprises — Background Information and Basis for Conclusions

Foreword

In October 2015, the Accounting Standards Board (AcSB) released the 2015 annual improvements to accounting standards for private enterprises 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 making these improvements.

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.

October 2015

INTRODUCTION

1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching their conclusions in approving the 2015 annual improvements to accounting standards for private enterprises. It sets out the reasons the AcSB undertook the project to improve 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 CPA Canada Handbook – Accounting. However, the discussion may help readers to understand how the AcSB reached its conclusions in developing the standards 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. The annual improvements process is one type of narrow-scope improvement.

4 The purpose of the annual improvements process is to amend accounting standards for private enterprises to clarify the wording in a standard or correct relatively minor unintended consequences, oversights or conflicts. These amendments are "bundled" together to reduce the number of individual changes to the standards.

5 The AcSB released an Exposure Draft, "2015 Annual Improvements to Accounting Standards for Private Enterprises," in February 2015. The Exposure Draft proposed amendments to four Sections as discussed in this document. The proposed amendments were in response to issues submitted to the AcSB by stakeholders. In deliberating the individual issues, 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.

7 The specific issues addressed in this improvements project, including substantive comments received on the Exposure Draft and any changes made in response to those comments, are as follows.

BUSINESS COMBINATIONS – DISCLOSURES

8 Prior to being amended, BUSINESS COMBINATIONS, Section 1582, required additional information to be disclosed by the enterprise when the subsidiary is consolidated. Some stakeholders thought that it was unclear whether the additional disclosures in paragraph 1582.62A also applied to a business combination achieved through the acquisition of an asset or group of assets. The AcSB noted that, in each case, the assets acquired and the liabilities assumed in a business combination are recognized in the acquirer's balance sheet. Consequently, the Exposure Draft proposed an amendment to clarify that disclosure of the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed should also be required when a business combination is achieved through the acquisition of an asset or group of assets. The AcSB noted that the other disclosure requirement in paragraph 1582.62A (i.e., the amount of non-controlling interest in the acquiree recognized at the acquisition date and the measurement basis for that amount) is only relevant when a business combination involves the acquisition of a subsidiary that is consolidated.

9 Respondents who commented on this proposed amendment agreed with the clarification to Section 1582; however, a few respondents suggested improvements. One respondent noted it is rare for the acquisition of a single asset to constitute a business combination and suggested changing the proposed wording to exclude such a situation. The AcSB decided that although it may be a rare situation for a business combination to be achieved through acquiring a single asset, it could still exist (for example, in the mining or real estate sector). Therefore, the AcSB concluded that a change to the proposed wording was not necessary.

10 One respondent suggested that guidance should be provided to help determine what constitutes a "material business combination" given there appears to be variation in the interpretation of this concept in practice. The AcSB discussed this issue and decided not to include additional guidance because materiality is a term used to describe the significance of financial statement information to decision makers. It is a matter of professional judgment in the particular circumstances to determine what constitutes a material business combination to those decision makers. Accordingly, the AcSB approved the amendments as exposed.

INVESTMENTS AND LEASES – DISCLOSURES

11 Prior to being amended, INVESTMENTS, Section 3051, and LEASES, Section 3065 contained requirements for recognizing an impairment loss and the reversal of a previously recognized impairment loss. However, neither Section required disclosure of such amounts. Some stakeholders questioned whether there should be a disclosure requirement similar to what is required in FINANCIAL INSTRUMENTS, paragraph 3856.52(e). Consequently, the Exposure Draft proposed an amendment to clarify that disclosure of the amount of any impairment loss or reversal of a previously recognized impairment loss is required. The proposed amendment to Section 3051 would apply to joint arrangements accounted for using the cost or equity method, in accordance with INTERESTS IN JOINT ARRANGEMENTS, paragraph 3056.41.

12 Respondents who commented on this proposed amendment agreed with the clarifications to Sections 3051 and 3065; however, a few respondents suggested improvements. One respondent suggested that the disclosure of the amount of any impairment loss or reversal of a previously recognized impairment loss should be made by "type of asset" to be consistent with the existing disclosures required in paragraph 3051.38. The AcSB agreed that a change was required to the proposed amendments.

13 Two respondents suggested that the proposed consequential amendments in INCOME STATEMENT, paragraph 1520.04(u), should also include subsidiaries that are accounted for using the cost or equity method in accordance with SUBSIDIARIES, Section 1591. The AcSB agreed to make this revision because paragraphs 1591.25 and 3056.41 refer to Section 3051 for the disclosure requirements when a subsidiary or a joint arrangement is accounted for using the cost or equity method. Although the impairment disclosure requirement is contained in Section 3051, the reference to Sections 1591 and 3056 is included to help direct stakeholders to this requirement.

14 There were two other issues raised that did not relate specifically to this proposed amendment. One issue related to whether the disclosure of the amount of write-down in inventory and the reversal of write-downs is needed in INVENTORIES, Section 3031. The other issue related to whether the requirement to disclose the carrying amount for operating lease receivables should be removed from Section 3065. The AcSB decided to consider these issues, along with the other issues noted in paragraph 29, in the 2016 annual improvements project to determine whether an improvement is required. Accordingly, the AcSB approved the amendments as exposed, subject to the drafting revisions described in paragraphs 12-13.

EMPLOYEE FUTURE BENEFITS – USE OF A FUNDING VALUATION

2014 Proposal

15 Paragraph 16 of the Background Information and Basis for Conclusions document for 2014 Improvements to Accounting Standards for Private Enterprises provides some background on this issue. It states:

> "EMPLOYEE FUTURE BENEFITS, Section 3462, permits the use of an actuarial valuation prepared for funding purposes to determine the obligation for an unfunded defined benefit plan. This option allows an entity that uses a funding valuation for funded defined benefit plans to measure all defined benefit plans on a consistent basis. The Exposure Draft proposed to clarify that the option to use a funding valuation for unfunded defined benefit plans can only be applied by entities that have at least one funded defined benefit plan."

16 The 2014 proposal resulted from the AcSB being informed by its Advisory Committee that some enterprises were using, or were considering using, a funding valuation for unfunded defined benefit plans when they did not have a funded defined benefit plan. For example, an enterprise may have an unfunded non-pension post-retirement defined benefit plan providing medical and dental benefits as well as a defined contribution plan, but may not have a funded defined benefit plan.

17 All respondents who commented on the 2014 proposed amendment agreed with the proposal in principle, although concerns were raised about its clarity. While the AcSB continued to agree with the proposed amendment, in light of these concerns, the AcSB decided to consider the issue further and not to include it in the final 2014 annual improvements.

2015 Proposal

18 The proposed 2015 annual improvements included a revised proposal. While the 2015 proposal was consistent with the 2014 proposal, the AcSB redrafted EMPLOYEE FUTURE BENEFITS, paragraphs 3462.029-.031, to clarify the wording and added a decision tree to help illustrate the requirements for determining when an entity can use a funding valuation to measure the defined benefit obligation for a defined benefit plan. The 2015 proposal also clarified that an actuarial valuation for funding purposes is one that is required to be prepared in order to comply with pension legislation or regulation.

19 All respondents agreed in principle with the 2015 proposed amendments to Section 3462. Supportive comments included statements that the 2015 proposal provided greater clarity than the 2014 proposal, was more helpful in achieving consistency in practice, and was more helpful in providing a clear framework for enterprises and their actuaries regarding how to prepare a funding valuation in the absence of legislative or regulatory requirements. However, most respondents suggested some improvements to further clarify the proposed amendments.

20 During its redeliberations, the AcSB recalled the cost / benefit considerations for the use of an actuarial valuation for funding purposes in place of an actuarial valuation for accounting purposes in measuring the defined benefit obligation for a defined benefit plan as the primary driver behind the development of Section 3462 (see paragraphs 52-56 and 60-65 of the Background Information and Basis for Conclusions document for Section 3462). The AcSB also recalled that the permission to use a funding valuation is an accommodation or "simplification" it made during the development of the employee future benefits standard in accounting standards for private enterprises (see paragraphs 47-55 of the Background Information and Basis for Conclusions document for Accounting Standards for Private Enterprises).

21 Most respondents questioned why a contractual requirement to prepare a funding valuation would not meet the proposed requirement even though it meets the existing criteria for a funding valuation (i.e., not prepared using a solvency, wind-up or similar valuation basis). These respondents explained that some private enterprises and not-for-profit organizations have no defined benefit plans except for funded supplemental executive retirement plans for their executives. These plans may contain a contractual obligation to have a funding valuation prepared, even if it is not required by pension legislation or regulation. An additional example of defined benefit plans with only contractual requirements to prepare a funding valuation includes funded non-pension post-retirement defined benefit plans such as those covering long-term disability benefits. They noted that, in this situation, private enterprises and not-for-profit organizations would incur additional costs in obtaining an accounting valuation, in addition to the funding valuation. They explained that a funding valuation is not required to be prepared in order to comply with pension legislation or regulation, and there may be no other defined benefit plans that require such a funding valuation. Some of these respondents thought that including contractual requirements would align with the underlying simplification and cost reduction principles of accounting standards for private enterprises for financial statement users and preparers.

22 One respondent shared the view that it was not appropriate to use a funding valuation based on contractual requirements, noting that contracts between plan sponsors and plan members for such plans may not provide sufficient guidance on how to prepare a funding valuation. This respondent thought that a funding valuation prepared on a contractual basis may be of lower quality than one prepared on a legislative or regulatory basis, including the risk that a plan sponsor may not meet all its contractual requirements. The Advisory Committee noted that all funding valuations must adhere to the Canadian Actuarial Standards of Practice whether the defined benefit plan is funded or not, and whether registered or not. On the basis that a consistent discipline exists regarding the methodology for the preparation of all funding valuations, the Advisory Committee recommended to the AcSB that the proposal be modified to include contractual requirements. The AcSB discussed this issue and agreed with the Advisory Committee's recommendation.

23 A couple of respondents questioned whether a funding valuation prepared in accordance with the Income Tax Act meets the proposed requirement. These respondents explained that individual pension plans may have funding valuations prepared in accordance with the requirements outlined by the Income Tax Act, (i.e., maximum funding valuation), rather than provincial pension legislation. They noted that the assumptions used in such valuations are not necessarily consistent with the assumptions used when a funding valuation is prepared in accordance with provincial pension legislation. One of these respondents thought that the proposed requirement would not capture these funding valuations and that adopting such proposals would increase valuation costs. This respondent suggested that funding valuations prepared in accordance with the Income Tax Act be permitted. The other respondent asked for clarification. The Advisory Committee recommended to the AcSB that the proposal be modified to permit requirements in accordance with the Income Tax Act, recalling the cost/benefit considerations for measurement of the defined benefit obligation of a defined benefit plan and the use of a funding valuation that occurred during the development of Section 3462 as described in paragraph 20 above. The AcSB confirmed its original intent that the objective was to not require an enterprise to have two valuations completed for a defined benefit plan. Therefore, the AcSB agreed with the Advisory Committee's recommendation, while specifically noting the reference to the funding valuation in the Income Tax Act that appears in paragraph 65 of the Background Information and Basis for Conclusions document for Section 3462 —

> "In finalizing the wording of Section 3462, the AcSB confirmed its intent to avoid a specific reference to the going concern funding valuation to allow entities with individual pension plans accounted for as defined benefit plans to use the funding valuation referred to in the Income Tax Act."

24 A third of respondents suggested an improvement relating to applying the accounting policy choices between a funding valuation or an accounting valuation depending on whether or not the plan has the required funding valuation. These respondents thought that it was confusing to categorize the choice that is on a plan-by-plan basis as an accounting policy because such a choice implies a consistent application to similar items or transactions. The AcSB retained the proposed requirement but simplified the drafting. The AcSB noted that when there is no requirement to prepare a funding valuation, an accounting policy choice that is made on a plan-by-plan basis to measure the defined benefit obligation using an accounting valuation or a funding valuation should be one that is applied retrospectively in accordance with the requirements in ACCOUNTING CHANGES, Section 1506, as described in existing paragraphs 3462.032-.033. Section 1506 includes disclosure requirements for accounting policies in accordance with DISCLOSURE OF ACCOUNTING POLICIES, Section 1505, (as a result of the cross-reference in paragraph 1506.02) and disclosure requirements for changes in accounting policies. The AcSB also noted that from a practical standpoint, enterprises would not likely change their accounting policies for measuring the defined benefit obligation for their defined benefit plans frequently given the need to apply any change retrospectively and given the likelihood of additional costs being incurred in obtaining a new actuarial valuation.

25 All respondents agreed in principle with including a decision tree with the final amendments to Section 3462. Supportive comments included statements that the Decision Tree is a useful aid for determining the measurement of the defined benefit obligation of a defined benefit plan, charts such as this one make it easier to analyze and "teach" the standards, and it is a helpful tool to use in arriving at an appropriate measurement conclusion when read in conjunction with the standard. However, most respondents suggested clarifying the accounting policy choices in the Decision Tree. The AcSB decided to add another box to distinguish between those accounting policy choices applied on a plan-by-plan basis and those applied to each defined benefit plan. Some respondents expressed concern that the wording in the Decision Tree was not as extensive as in the standard. The AcSB noted that a decision tree acts as an aid that is to be read in conjunction with the standard, and is not a replacement for the standard. However, during its redeliberations, the AcSB decided to redraft the title and lead-in sentence to be more specific in terms of its purpose, and to add footnotes to clarify requirements.

26 In testing various defined benefit plans using the Decision Tree, the AcSB noted that the preferred accounting is to prepare an accounting valuation for a defined benefit plan. However, an enterprise can use the permitted accommodation or "simplification" to apply a funding valuation to a defined benefit plan in which there is no legislative, regulatory or contractual requirement provided that enterprise has at least one defined benefit plan for which a funding valuation is required to be prepared in order to comply with legislative, regulatory or contractual requirements and for which the defined benefit obligation has been measured using a funding valuation.

27 In considering this accommodation, a couple of respondents raised the need for guidance on the meaning of "on a basis consistent with" in preparing a funding valuation for an unfunded defined benefit plan. The AcSB noted that this issue was beyond the scope of the 2015 annual improvements and will consider how to address this issue in the future.

PROPERTY, PLANT AND EQUIPMENT – DISCLOSURES

28 The AcSB decided to modify the disclosure requirement in PROPERTY, PLANT AND EQUIPMENT, Section 3061, by removing the words "an item of" in paragraphs 3061.25-.26. Those two paragraphs required the disclosure of the carrying amount "of an item of property, plant and equipment" not being amortized, and the amortization "of an item of property, plant and equipment." This amendment clarifies the disclosure requirement by removing the notion that separate disclosures are required for each item. Although the amendment is not editorial in nature, this change reflects how the disclosure requirement is being applied in practice. The AcSB decided not to include this change in the Exposure Draft because it thought that no additional information would be gained from requesting stakeholder input. Instead, this change was included in the final 2015 annual improvements.

OTHER ISSUES

29 Several 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 include them as part of the 2016 annual improvements project.

EFFECTIVE DATE

30 The Exposure Draft proposed that the amendments be effective for annual financial statements beginning on or after January 1, 2016, with earlier application permitted. Respondents agreed with this proposal and, accordingly, the AcSB finalized the effective date as proposed.

31 The Exposure Draft also included editorial corrections to paragraphs 1520.04(k)(v), 1582.63(a) and 3856.52(e) that apply upon the release of the 2015 annual improvements to accounting standards for private enterprises. These changes are included in the "Other editorial changes and corrections introduced in October 2015."
