FINANCIAL REPORTING

INTRODUCTION

When it comes to the *Financial Reporting* competency, the challenge that many students face is the tremendous amount of technical knowledge included in this competency, especially in light of the fact that students are responsible for both IFRS and Accounting Standards for Private Enterprises (ASPE).

The technical review notes cover the major financial accounting topics that we would expect to come up on the CFE. The notes recognize that few human beings are capable of knowing every detail of every accounting standard and that fortunately this is likely not necessary, in order to pass the CFE. The summaries of the various topics are therefore condensed and do not endeavor to cover every last detail of a given topic. Rather they focus on the key aspects of each topic that we believe have the greatest probability of being examined. The notes assume that the student already has a reasonable knowledge of each of the topics and is looking for a quick way to review financial accounting.

These notes will be appropriate both for both students who have chosen financial reporting as a depth area as well as those who have not.

<u>Scope of Binder</u>

The binder does not cover 100% of the topics in the CPA Canada Handbook. It, however, covers all major topics that we would expect to be tested in detail on the CFE, as students can easily review the minor topics on their own by reviewing the relevant standards in the Handbook.

A listing of topics that are not summarized in the notes, is included in the appendix at the end of the notes.

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NON – CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

INTRODUCTION

Under ASPE topic is covered under Handbook section 3475 *Disposal of Long Lived Assets and Discontinued Operations*

Topic is covered under international standards under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Presentation is based on IFRS with any significant differences between IFRS and ASPE highlighted

SCOPE

IFRS 5 applies to all recognized non-current assets and disposal groups of an entity except for deferred tax assets, assets arising from employee benefits, financial instruments, biological assets and investment properties accounted for at fair value

Comparison with ASPE

Scope under ASPE is narrower

Section 3475 applies to the disposal of non-monetary long-lived assets, including property, plant and equipment, intangible assets with finite useful lives and long-term prepaid assets and specifically excludes investments and disposal of goodwill

TYPES OF SITUATIONS COVERED BY IFRS 5

IFRS 5 covers 2 situations:

1) Assets held for sale –

   Includes non – current assets or disposal groups* held for sale to third parties

2) Assets held for distribution to owners –

   Includes non-current asset or disposal group* held for distribution to owners acting in their capacity as owners

*Disposal group is a group of assets to be disposed of by sale or otherwise, together or as a group in a single transaction and liabilities directly associated with those assets that will be transferred in the transaction.

Impact of Classification

Whether item is classified as held for sale or held for distribution impacts 3 issues:

1) Measurement
2) Classification and presentation
3) Disclosure

Comparison with ASPE

ASPE only has the first category – Held for sale

Assets held for distribution to owners would continue to be classified as "held" until they are disposed of

For assets held for sale under ASPE the same 3 issues would be impacted

CONDITIONS FOR CLASSIFICATION AS HELD FOR SALE

Asset/disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets/disposal groups and its sale must be highly probable

Highly probable means more likely than probable, where probable is more likely than not

Conditions for sale to be considered "highly probable"

1. Appropriate level of management must be committed to a plan to sell

2. Active program to locate a buyer and complete the plan must have been initiated

3. Must be actively marketed for sale at price that is reasonable in relation to its current fair value

4. Sale expected to qualify for recognition as a completed sale within one year from the date of classification, except where delay is caused by events or circumstances beyond the control of the entity and the entity is still committed to its plan to sell and

5. Unlikely that significant changes to plan will be made or plan will be withdrawn

The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable

Comparison with ASPE

Similar conditions need to be fulfilled

CONDITIONS FOR CLASSIFICATION AS HELD FOR DISTRIBUTION

Conditions similar to conditions for held for sale, with modification to take into account distribution to owners rather than sale

Asset/disposal group must be available for immediate distribution in their present condition and the distribution must be highly probable

For the distribution to be highly probable, actions to complete the distribution

1) Must have been initiated and should be expected to be completed within one year from the date of classification; and
2) Should indicate that it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn.

Comparison with ASPE

N/A as this classification does not exist under ASPE

MEASUREMENT

IFRS requires that an entity measure a non-current asset (or disposal group) held for sale at the lower of:

1. Carrying value
2. Fair value less cost to sell

Depreciation would no longer be taken

Cost to sell are the incremental direct costs to transact a sale (e.g. broker commissions, legal and title transfer fees and closing costs etc.)

Same rules for measurement under ASPE

Under IFRS same measurement rules would apply for assets held for distribution to owners

Would measure at lower of its carrying amount and fair value less incremental costs to distribute

GAINS AND LOSSES

When an asset/disposal group is written down to fair value less cost to sell, loss would be recognized

Same under ASPE

If fair value less cost to sell subsequently increases, would write up asset and recognize gain; however the gain cannot exceed the cumulative impairment loss recognized under this IFRS (i.e. IFRS 5) since asset was classified as "Held for Sale" plus the impairment loss taken under IAS 36 "Impairment of Assets" while the asset was still classified as held (if relevant)

<u>Example</u>

E.g. At the end of the first quarter of the year, carrying value of land is $1,000,000 and land was classified as Held (as opposed to held for sale).

Company uses the cost model to value the land

Asset was not recoverable, so it was written down under IFRS 36 *Impairment of Assets* to recoverable amount of $950,000 and impairment loss of $50,000 was recognized in the first quarter

At end of the second quarter land was reclassified as held for sale and fair value less cost to sell was $875,000. Land therefore written down under IFRS 5 to $875,000 and a loss of $75,000 was recognized in the second quarter

By the end of the third quarter fair value (less costs to sell) of land had increased to $1,050,000

Gain of $125,000 would be recognized during the third quarter, and as at the end of the third quarter, land would be valued at $1,000,000

Comparison with ASPE

Under ASPE also possible to recognize gain when fair value less cost to sell subsequently increases; however maximum increase would be based on the cumulative impairment loss taken under HB Section 3475 (which deals with assets held for sale) only

No reversal of impairments under HB section 3063 "Impairment of Long Lived assets" (the equivalent to IAS 36 under IFRS)

In above example, gain recognized in third quarter would be $75,000 (i.e. a reversal of the loss recognized once the asset was classified as held for sale)

NON-CURRENT ASSETS THAT ARE TO BE ABANDONED

Entity would **not** classify as held for sale a non-current asset (or disposal group) that is to be abandoned as carrying amount will be recovered principally through continuing use

ASPE provides similar guidance

CHANGES TO PLAN OF SALE

When an asset or disposal group no longer meets the conditions to be re-classified as held for would be removed from the held for sale category and re-measured at lower of:

A) Carrying value had asset not been classified as held for sale and

B) Recoverable amount (i.e. higher of fair value less cost to sell and value in use) at the date of decision not to sell

ASPE is similar to IFRS except that under condition B, fair value rather than recoverable amount is used

SUBSIDIARY

Under IFRS, entity committed to a sale plan involving loss of control of a subsidiary would classify all the assets and liabilities of that subsidiary as held for sale when the criteria for reclassification as held for sale (discussed below) are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale

CLASSIFICATION OF NON-CURRRENT ASSET OR DISPOSAL GROUP IN FINANCIAL STATEMENTS

Would present a non-current asset/disposal group/liabilities classified as held for sale separately from other assets/liabilities in the statement of financial position

Assets and liabilities cannot be offset and presented as a single amount

Same under ASPE

Must present separately any cumulative income or expense recognized in OCI relating to an asset classified as held for sale

No statement of comprehensive Income under ASPE

No mention of whether to classify asset (disposal group) classified as held for sale as current versus non-current

Comparison with ASPE

Under ASPE, Long-lived assets classified as held for sale reclassified as current assets if entity has sold assets prior to date of completion of the financial statements and proceeds of sale will be realized within a year of the date of the balance sheet, or within the normal operating cycle if longer

If the assets classified as current, any liabilities to be assumed by the purchaser or required to be discharged on disposal of the assets also classified as current

ASSETS (DISPOSAL GROUP) ACQUIRED WITH A VIEW TO SUBSEQUENT DISPOSAL

Would classify as held for sale at the acquisition date only if the one-year requirement (discussed above) is met and highly probable that any of the other criteria for classification as held for sale (discussed earlier) that are not met at the acquisition date will be met within a short period following the acquisition (usually within three months)

Similar rule under ASPE

Measurement at date of acquisition would be at the lower of carrying value had asset not been classified as held for sale (e.g. cost) and fair value less cost to sell

Under ASPE would always measure at date of acquisition based on fair value less costs to sell

PRESENTATION OF DISCONTINUED OPERATIONS

Conditions for Treatment as Discontinued Operation

Results of operations should be reported in discontinued operations if:

1. They relate to a "<u>component</u>" of an enterprise

   Component comprises operations and cash flows that can be clearly distinguished operationally and for financial-reporting purposes from the rest of the enterprise

   Would have been a cash-generating unit or a group of cash-generating units while being held for use

2. The operation <u>has either been disposed</u> of or is classified as "<u>held for sale</u>"

And

<u>One</u> of the following conditions is met for the component:

(a) Represents a separate major line of business or geographical area of operations

(b) Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or

(c) Is a subsidiary acquired exclusively with a view to resale

<u>Comparison with ASPE</u>

Rules are the same under ASPE

<u>ALLOCATION OF CORPORATE OVERHEAD</u>

Would only include in income/loss from discontinued operations costs that are clearly identifiable as costs of the component being disposed of and that will not be recognized on an ongoing basis

ASPE provides similar guidance; it states explicitly that corporate overhead may not be allocated to a discontinued operation