Accounting Standards for Private Enterprises (ASPE) Briefing

A NEW LIGHT ON ACCOUNTING FOR INVESTMENTS

Primary Standards Discussed:
• Section 1591, Subsidiaries
• Section 3051, Investments
• Section 3056, Interests in Joint Arrangements
Accounting Standards for Private Enterprises (ASPE) Briefing

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This publication was originally issued in May 2016 and has been updated in June 2017 for the December 2016 amendments to the standards on accounting for investments. Readers are cautioned that certain aspects of ASPE may have changed since the publication date.

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Table of Contents

Part A—Introduction and Scope

Purpose of this ASPE Briefing 1
Effective Dates 2
Types of Investments 3
Scope of this ASPE Briefing 4
  Applicability to Not-for-Profit Organizations (NFPOs) 5
  Outside the scope of this ASPE Briefing 5
Summary of Main Standards Related to Investments 6

Part B—Section 3056, Interests in Joint Arrangements 9

Scope 9
Effective Date 9
What Is a Joint Arrangement under Section 3056? 9
Three Types of Joint Arrangements 10
Summary of the Types of Joint Arrangements and Accounting Methods 12
Contributions and Transactions 14
Presentation and Disclosure 15
Part C—Section 3051, Investments

Scope

Effective Date

Accounting Methods When Significant Influence is Present
  Equity Method
  Cost Method
  Using Fair Value or Quoted Amount (Sometimes Referred to as the “Fair Value Method”)

Transactions Between the Investor and Investee
  Initial Contributions
  Subsequent Transactions

Impairment

Presentation and Disclosure

Part D—Section 1591, Subsidiaries

Scope

Effective Date

Control

Recognition and Presentation

Measurement

Disclosure

Part E—Other Resources

Appendix A—An Example of the Equity Method

Appendix B—Examples of Initial Contributions for a Jointly Controlled Enterprise (JCE)—Accounted for Using the Equity Method

Initial Contribution of Capital Assets
  Scenario A
  Scenario B
Appendix C—Examples of Transactions between Investor and Investee—Accounted for Using the Equity Method 43

Appendix D—Summary of Key Changes and Transition Guidance 45

Key Changes to Section 3056, Interests in Joint Arrangements and Section 3051, Investments, (with notations for the December 2016 amendments when appropriate) 45
  
  New Guidance on the Accounting for Contributions 47
  
  Examples of Joint Arrangements—Initial Contribution of Capital Assets 47
  
  Transition Guidance for Section 3051 49
  
  Transition Guidance for Section 3056 50

Section 1591, Subsidiaries 51
  
  Key Changes 52
  
  Disclosure 53
  
  Transition Guidance for Section 1591 53
  
  Consolidating a Previously Unconsolidated Subsidiary (paragraph 1591.42) 53
  
  Deconsolidating a Previously Consolidated Subsidiary (paragraph 1591.46) 54
  
  Transition Adjustments 55

Implications of the Changes 59

Things to Remember When Transitioning 59

Consequential Amendments 59

Appendix E—Accounting for Investments—Points to Remember 61
## Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AcSB</td>
<td>Accounting Standards Board</td>
</tr>
<tr>
<td>ASPE</td>
<td>Accounting Standards for Private Enterprises</td>
</tr>
<tr>
<td>JA</td>
<td>Joint Arrangement</td>
</tr>
<tr>
<td>JCE</td>
<td>Jointly Controlled Enterprise</td>
</tr>
<tr>
<td>JCO</td>
<td>Jointly Controlled Operation</td>
</tr>
<tr>
<td>JCA</td>
<td>Jointly Controlled Asset</td>
</tr>
<tr>
<td>NFPO</td>
<td>Not-for-Profit Organization</td>
</tr>
<tr>
<td>PV</td>
<td>Present Value</td>
</tr>
</tbody>
</table>
PART A
Introduction and Scope

Purpose of this ASPE Briefing
Accounting for investments can be complex because many different types of investments exist and different policy choices are available within ASPE for use when accounting for such investments. This ASPE Briefing is primarily designed to assist in the application of the following new and amended Sections in ASPE:
1. Section 1591, Subsidiaries (new: replaces Section 1590, Subsidiaries and Accounting Guideline 15 (AcG-15), Consolidation of Variable Interest Entities)
2. Section 3051, Investments (amended)
3. Section 3056, Interests in Joint Arrangements (new: replaces Section 3055, Interests in Joint Ventures)

This ASPE Briefing was updated to reflect the clarifications and amendments issued in December 2016.

This ASPE Briefing will also revisit some of the existing application issues that are not new but may be encountered for the first time (e.g., application of the equity method).

This ASPE Briefing will:
• provide explanations on hot topics or complex areas within the standards
• answer frequently asked questions (FAQs)
• provide illustrative examples
To be consistent with the wording in the standards, the parties in an investment relationship will be referred to as the investor and investee:

![Diagram showing investor and investee relationships]

**Effective Dates**

Sections 3056 and 1591 and the amendments to Section 3051 applied to annual financial statements relating to fiscal years beginning on or after January 1, 2016, although early adoption was permitted. These Sections were subsequently updated in December 2016 to clarify the transitional guidance, to include other clarifying amendments, and to provide guidance on the application of the cost method. The following chart provides a summary of the amendments classified by section and effective date:

<table>
<thead>
<tr>
<th>Effective Date</th>
<th>Section 1591, Subsidiaries</th>
<th>Section 3051, Investments</th>
<th>Section 3056, Interests in Joint Arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017 (Effective for Annual Periods Beginning on or after January 1, 2017)</td>
<td>• Amendments to transitional guidance; and • Preparation of non-consolidated financial statements – subsidiaries controlled through contractual arrangements</td>
<td></td>
<td>• Amendments to transitional guidance</td>
</tr>
<tr>
<td>2018 (Effective for Annual Periods Beginning on or after January 1, 2018)</td>
<td>• Application of cost method, and some additional clarifying amendments</td>
<td>• Application of cost method and • Indicators of impairment</td>
<td></td>
</tr>
</tbody>
</table>

The specific considerations for transition will be discussed in Appendix D of this ASPE Briefing.
Types of Investments

Private enterprises often hold various types of investments. Some industries such as real estate development, real estate rental, construction and oil and gas are more likely to structure their activities through a number of investment vehicles. Some investments are not strategic in nature; they result instead from the investment of surplus financial resources to earn a return and should be classified as financial assets covered within the scope of Section 3856, Financial Instruments. Section 3856 is not covered in this ASPE Briefing.

FAQ

What are some examples of the different types of investments that can be held by a private enterprise?

- shares of a public company
- shares of a private company
- bonds traded in the public market
- private bonds or loans receivables
- derivative instruments
- non-financial items such as works of art or other tangible assets
- joint arrangements
- partnerships
- entities controlled through a contractual arrangement

Note: The above is not an exhaustive list.

Accounting for the investment often involves policy choices once the nature and intent of the investment is identified.

The first step in accounting for investments is to identify which investments exist (i.e., investments in equity instruments, non-financial assets, an interest through means other than equity interests in another enterprise, etc.). Then the relationship must be assessed. The accounting for the investments held by a private enterprise varies with the classification and policy choices made under ASPE.

For investments in equity securities, the degree of influence or control will determine the classification and accounting for the investment by the investor. Figure 1 illustrates the continuum of control, as follows:

**FIGURE 1: CONTINUUM OF CONTROL**
Therefore, before addressing the specific new/amended standards, the following chart is presented to provide a summary of the types of investment that may be held by a private enterprise organized according to the relevant Sections in ASPE.

<table>
<thead>
<tr>
<th><strong>Section 3856, Financial Instruments</strong></th>
<th><strong>Section 3051, Investments</strong></th>
<th><strong>Section 3056, Interests in Joint Arrangements</strong></th>
<th><strong>Section 1591, Subsidiaries</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments in equity instruments quoted in an active market without significant influence, joint control or control and derivative instruments</td>
<td>Investments in equity instruments not quoted in an active market without significant influence, joint control or control</td>
<td>Investments subject to significant influence</td>
<td>Controlled investments</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The policy choices for those investments subject to significant influence are discussed later in this ASPE Briefing. See Part C.</td>
<td>The policy choices for investments subject to joint control Categories include: • joint operations • joint assets • jointly controlled enterprises. The policy choices for the various types of interest in joint arrangements are discussed later in this ASPE Briefing. See Part B.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other non-financial instrument investments (e.g., works of art and other tangible assets held for investment purposes)</td>
<td></td>
</tr>
<tr>
<td>Investments in other financial assets (e.g., bonds, loans receivable)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Scope of this ASPE Briefing**

The accounting for the many different classifications of investments can be complex and involves many interrelated standards. As mentioned, this ASPE Briefing will address the following standards:

- new Section 1591, Subsidiaries
- amended Section 3051, Investments
- new Section 3056, Interests in Joint Arrangements

This ASPE Briefing will address the new Section 3056, Interests in Joint Arrangements, in Part B first and in the greatest depth since it will potentially be the most significant change to the financial statements for those applying ASPE.
Applicability to Not-for-Profit Organizations (NFPOs)

Although this ASPE Briefing will focus on private enterprises, it should be noted that some of the guidance in these standards may be applicable to NFPOs.

If an NFPO uses the equity method in accordance with Section 4450, Reporting Controlled and Related Entities by Not-for-Profit Organizations, in Part III of the CPA Canada Handbook—Accounting, then revised Section 3051 applies. Section 4450 requires the equity method to be used by an NFPO for an investment in a significantly influenced profit-oriented enterprise. An NFPO also has an accounting policy choice to apply the equity method for an investment in:

- a controlled profit-oriented enterprise
- a joint venture

The new accounting in Section 3056 does not apply to NFPOs. Section 4450 retained the accounting previously in Section 3055 and will be re-examined as part of a future project on Reporting Controlled and Related Entities by NFPOs.

Outside the scope of this ASPE Briefing

This ASPE Briefing will address the following topics only to the extent that they are relevant to the accounting for certain investments:

- Section 3831, Non-monetary Transactions
- Section 3840, Related Party Transactions
- AcG-18, Investment Companies, which covers the accounting for investments held by investment companies. (The determination of whether an enterprise is an investment company is addressed in paragraphs 8 and 9 of that Guideline.)
- Section 3856, Financial Instruments
### Summary of Main Standards Related to Investments

The following is a summary of the main guidance from each of the standards discussed in this ASPE Briefing and how they are interrelated:

<table>
<thead>
<tr>
<th>Type of investment</th>
<th>Section 3051, Investments</th>
<th>Section 3056, Interests in Joint Arrangements</th>
<th>Section 1591, Subsidiaries</th>
</tr>
</thead>
</table>
| Provides guidance on the accounting for any investment (except for financial instruments accounted for under Section 3856) using the cost or equity method, and for works of art and other tangible assets held for investment | Provides guidance on the accounting for joint arrangements where joint control exists Depending on the type of joint arrangement, the following accounting methods may be applied:  
• cost method (refers back to Section 3051)  
• equity method (refers back to Section 3051)  
• recognition of the interest in the individual assets, obligations, revenue and expenses of the joint arrangement. | Provides guidance on the accounting for investments where control exists (amended December 2016) The following accounting methods may be applied:  
• cost method  
• equity method (refers back to Section 3051)  
• consolidation (refers back to Section 1601, Consolidated Financial Statements). |

| Applicability | Applicable to:  
• investments in equity instruments of others subject to significant influence  
• investments in a jointly controlled enterprise (JCE) when the equity or cost method is applied in accordance with Section 3056  
• investments in a subsidiary when the equity or cost method is applied in accordance with Section 1591 | Applicable to ALL joint arrangements:  
• jointly controlled assets  
• jointly controlled operations  
• jointly controlled enterprises | Applicable to ALL subsidiaries including those controlled through:  
• voting interests  
• means other than equity interests (e.g., contractual arrangements)  
Remember: A subsidiary may take many forms, including a corporation, trust, partnership or unincorporated enterprise. (See paragraph 1591.04). |

<p>| Guidance on accounting for contributions and transactions | Addresses the accounting for contributions and transactions (See paragraphs 3056.19-.26 for JCOs and JCAs, and 3056.33 for JCEs) Refers back to Section 3051 when the equity or cost method is applied | Addresses the accounting for contributions and transactions | Refers back to Section 1601, Consolidated Financial Statements when consolidation is applied or Section 3051, Investments for subsidiaries using the cost or equity method |</p>
<table>
<thead>
<tr>
<th><strong>Part A</strong></th>
<th><strong>Introduction and Scope</strong></th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th><strong>Section 3051, Investments</strong></th>
<th><strong>Section 3056, Interests in Joint Arrangements</strong></th>
<th><strong>Section 1591, Subsidiaries</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Impairment</strong></td>
<td>Addresses accounting for impairment (amended December 2016) (See paragraphs 3051.23-.27)</td>
<td>Addresses accounting for impairment for jointly controlled assets or jointly controlled operations and refers to Section 3064, Goodwill and Intangible Assets and Section 3063, Impairment of Long-Lived Assets as appropriate guidance</td>
</tr>
<tr>
<td><strong>Gains/losses on sale</strong></td>
<td>Addresses accounting for gains and losses on sale of an investment (See paragraphs 3051.28-.30)</td>
<td>Specifically addresses potential sale for JCE: An interest in a JCE that is intended for disposal continues to be recognized in the financial statements of the investor until such time as the investor ceases to have joint control over the JCE. The provisions of Section 3475, Disposal of Long-lived Assets and Discontinued Operations would apply when the specified criteria are met. (See paragraph 3056.32)</td>
</tr>
<tr>
<td><strong>Presentation</strong></td>
<td>Addresses presentation issues (See paragraphs 3051.31-.33)</td>
<td>Addresses what items must be presented separately on the income statement and balance sheet (See paragraphs 3056.34-.36)</td>
</tr>
<tr>
<td><strong>Disclosure</strong></td>
<td>Addresses disclosure (See paragraphs 3051.34-.38)</td>
<td>Also refers to disclosures in Section 3280, Contractual Obligations; Section 3290, Contingencies and Section 3840, Related Party Transactions (See paragraphs 3056.37-.42)</td>
</tr>
</tbody>
</table>
PART B
Section 3056, *Interests in Joint Arrangements*

**Scope**
Section 3056 establishes standards for investments in arrangements in which the investor has joint control. Note that Section 3056 deals with the accounting by the investor and does not deal with accounting by the joint arrangement itself.

**Effective Date**
As identified in the Introduction of this ASPE Briefing, Section 3056 was effective for annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application was permitted but, if adopted early, the enterprise must disclose that fact and apply paragraphs .14-.17 of Section 3051, *Investments* at the same time.

Section 3056 was amended in December 2016 to clarify that the transitional provisions can only be used on transition to Section 3056 or on the initial adoption of ASPE. The amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2017, with earlier application permitted.

A discussion of the transition matters is included in Appendix D of this ASPE Briefing.

**What Is a Joint Arrangement under Section 3056?**
Paragraph 3056.03(c) provides the following definition:

A **joint arrangement** is an economic activity resulting from a contractual arrangement whereby two or more investors jointly control the economic activity.
It should be noted that Section 3056 does not use the term “joint venture”. The key is to understand the nature of the arrangement as a JCA, JCO or JCE. A contract or other material may refer to the arrangement as a joint venture, but its substance will determine how it should be classified.

The key factor is the assessment of joint control, which is defined in paragraph 3056.03(b) as follows:

**Joint control** of an economic activity is the contractually agreed sharing of the continuing power to determine its strategic operating, investing and financing policies.

Section 3056 applies to those investments that meet the criteria of a joint arrangement regardless of what it is actually referred to in any underlying agreements or documentation (e.g., the documentation may use terms such as joint venture, partnership, corporation, trust, etc.).

In addition, Section 3056 does not apply when economic activities do not meet the definition and criteria of a joint arrangement even though they may sometimes be referred to as joint arrangements or joint ventures. The accounting for investments is governed by the nature of the investments.

**Three Types of Joint Arrangements**

The legal structure and the terms within all related agreements must be reviewed to determine the nature of the arrangement. Based on the facts and circumstances of each arrangement, the substance of the arrangement may be different than its legal form. The features of the three types of joint arrangements under Section 3056 are summarized as follows:

<table>
<thead>
<tr>
<th>Jointly Controlled Assets (JCAs)</th>
<th>Jointly Controlled Operations (JCOs)</th>
<th>Jointly Controlled Enterprises (JCEs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arrangement to <strong>share the use</strong> of assets only.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The investor has rights to the individual assets and obligations for the individual liabilities relating to the JCA.</td>
<td>Arrangement to <strong>share the operations</strong>—revenue and expenses.</td>
<td></td>
</tr>
<tr>
<td>The investor has rights to the individual assets and obligations for the individual liabilities incurred by the JCO.</td>
<td>Arrangement to <strong>share a separate enterprise</strong>.</td>
<td></td>
</tr>
<tr>
<td>The investor has rights to the net assets of the JCE.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Jointly Controlled Assets (JCAs)
Involves the joint control (and often the joint ownership) by the investors of one or more assets contributed to or acquired for the purposes of the joint arrangement and dedicated to the purposes of the joint arrangement.
*(See paragraphs 3056.12-13)*

### Jointly Controlled Operations (JCOs)
Involves the use of the assets and other resources of the investors *(i.e., not a corporation, partnership or other enterprise, or a financial structure separate from the investors themselves).*

The assets *(e.g., property, plant and equipment; inventories; etc.) remain under the ownership and control of each investor. Each investor also incurs its own expenses and liabilities and raises its own financing, which represents its own obligations.*
*(See paragraphs 3056.10-11)*

### Jointly Controlled Enterprises (JCEs)
Involves the establishment of a corporation, partnership or other enterprise in which each investor has an interest.
*(See paragraphs 3056.14-15)*

<table>
<thead>
<tr>
<th>Example:</th>
<th>Example:</th>
<th>Example:</th>
</tr>
</thead>
<tbody>
<tr>
<td>The sharing of a jointly controlled warehouse, or a jointly controlled rental property.</td>
<td>The sharing of the operations when one party has the building and the other has equipment and labour force.</td>
<td>An enterprise is created and the investors have an investment in the net equity of the JCE that owns and operates a warehouse.</td>
</tr>
</tbody>
</table>

| Represents an investment in an asset (building). | Represents an investment in the net assets of the warehouse operations. | Represents an investment in the net equity of the separate enterprise. |
Summary of the Types of Joint Arrangements and Accounting Methods

As indicated in the above summary, there are three choices for the accounting for a JCE, which are discussed below:

**Choice #1:** If an investor uses the equity method to account for a JCE, the guidance for the equity method is found in Section 3051, *Investments* discussed in Part C of this ASPE Briefing.

**Choice #2:** If an investor uses the cost method to account for a JCE, the guidance for the cost method is found in Section 3051, *Investments*. 
**Choice #3:** Section 3056 recognizes that the substance of a joint arrangement may be that the investor has an interest in the individual assets and liabilities of a JCE rather than in the net assets. It therefore provides an “additional analysis option” to determine the substance of the arrangement. Each JCE would be assessed separately.

Interests in a JCE that the analysis shows to be, in substance, interests in the individual assets and liabilities must be accounted for as such rather than by the cost or equity methods permitted in Choices #1 and #2.

Although the legal form of the arrangement is relevant in assessing whether the investor has a right to the net assets or individual assets and liabilities of the JCE, there are other factors to be considered. The decision tree from paragraph 3056.A11 is useful for the performance of the analysis of each interest:

**DECISION TREE—CLASSIFICATION OF AN INVESTOR’S INTEREST IN A JOINTLY CONTROLLED ENTERPRISE**

1. **Legal form of the jointly controlled enterprise**
   - Does the legal form of the jointly controlled enterprise give the investors rights to the assets, and obligations for the liabilities, relating to the jointly controlled enterprise?
     - Yes: Investor has rights to the individual assets, and obligations for the individual liabilities, relating to the jointly controlled enterprise (see paragraphs 3056.17-.18)
     - No: Terms of the contractual arrangement
2. **Terms of the contractual arrangement**
   - Do the terms of the contractual arrangement specify that the investors have rights to the assets, and obligations for the liabilities, relating to the jointly controlled enterprise?
     - Yes: Have the investors designed the jointly controlled enterprise so that:
       - (a) its activities primarily aim to provide the investors with an output (i.e., the investors have rights to substantially all the economic benefits of the assets held in the jointly controlled enterprise) and
       - (b) it depends on the investors on a continuous basis for settling the liabilities relating to the activity conducted through the jointly controlled enterprise?
     - No: Investor has rights to the net assets of the jointly controlled enterprise (see paragraphs 3056.29(a)-(b))

   - No: Other facts and circumstances
The accounting treatment for each interest after this analysis is as follows:

- If the right is to **net assets**, then apply either the equity or cost method consistently for all such interests.
- If the right is to **individual assets and liabilities**, then recognize its share of assets, liabilities, revenue and expenses.

In performing the additional analysis option, the terms within all related contractual agreements must be reviewed to determine the substance of the arrangement. Paragraph A5 of Appendix A in Section 3056 provides guidance on common terms in contractual arrangements and whether the arrangement does provide the investor with a right to the net assets of a JCE or a right to the individual assets and obligations for the individual liabilities of a JCE. Each arrangement is unique; the analysis is based on the facts and circumstances of the specific agreement and arrangement.

**FAQ**

*A policy choice exists under Section 3056 to perform an analysis to determine whether the interest in the JCE represents a right to net assets or a right to the individual assets and obligations. Why would I select to perform the analysis?*

The standard does not require the analysis in Choice #3 because, in most cases, the result of the analysis will show that there is an interest in the net assets. Requiring this analysis for all JCEs would not meet a cost/benefit test. However, where the interest in a JCE is in substance an interest in individual assets and the obligation is for individual liabilities, then Choice #3 permits an enterprise to present the individual assets and liabilities in their financial statements rather than use the cost or equity method.

For an enterprise that currently applies proportionate consolidation, Choice #3 may permit them to apply similar accounting, thus minimizing the changes to the financial statements upon adoption of the standard. However, as previously noted, most JCEs are an interest in net assets and must be accounted for using the cost or equity method. It is expected to be rare to conclude that the investor in a JCE has rights to the individual assets and obligations.

**Contributions and Transactions**

The guidance on contributions and transactions for JCOs and JCAs is discussed in Section 3056 (see paragraphs 3056.19-.26).

The guidance on contributions and transactions for JCEs is a bit more detailed since it considers the possibility that the equity method may be applied.
• If the investor uses the equity method to account for the joint arrangement, contributions and transactions are accounted for in accordance with Section 3051, Investments. The accounting for contributions and transfers when the enterprise uses the equity method is discussed in Part C of this ASPE Briefing. Examples are provided in Appendices B and C.

• If the investor accounts for the interest in the joint arrangement as an interest representing rights to the individual assets and obligations for individual liabilities, contributions and transactions are accounted for in accordance with the guidance for JCOs and JCAs in paragraphs 3056.19-.26 mentioned above (see paragraph 3056.33).

**Presentation and Disclosure**

Section 3056 provides guidance on the presentation on the balance sheet (see paragraph 3056.34) and the income statement (see paragraph 3056.35) and points out the following in paragraph 3056.36:

A significant factor in evaluating the investment income is the relationship of the income reported to the investments from which such income is derived. For this reason, investments reported in the balance sheet and investment income reported in the income statement are grouped in the same way.

The specific disclosure requirements are provided in paragraphs 3056.37-.42 with specific reference to the following related Sections:

• Section 3280, *Contractual Obligations*
• Section 3290, *Contingencies*
• Section 3840, *Related Party Transactions*

For joint arrangements accounted for using the cost or equity method, the disclosures required by Section 3051, *Investments* must also be met.

Since Section 3056 may result in the application of the equity method, a non-complex example of the application of this method is included in Appendix A of this ASPE Briefing.
PART C
Section 3051, Investments

Scope
Investments within the scope of Section 3051 include (see paragraphs 3051.01-.03):
• investments subject to significant influence
• other non-financial instrument investments (e.g., works of art and other tangible assets held for investment purposes)
• investments in subsidiaries where the investor is applying the equity method
• interests in joint arrangements categorized as a JCE where the investor is applying the cost or equity method

Investments outside the scope of Section 3051:
• consolidated subsidiaries
• interests in joint arrangements where the investor is not applying the cost or equity method as a policy choice
• financial instruments within the scope of Section 3856, Financial Instruments
• investments held by investment companies which are within the scope of AcG-18, Investment Companies

Effective Date
As identified in the Introduction of this ASPE Briefing, the amendments to Section 3051 are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted but, if adopted early, paragraph 3051.41 asserts that Section 3056, Interests in Joint Arrangements must be applied at the same time.

Section 3051 was further amended in December 2016 to provide guidance on how to apply the cost method on initial recognition. The amendments also provide guidance on impairment improve disclosure requirements when the cost method is used.
The 2016 amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2018, and may be applied prospectively. Earlier application permitted.

A discussion of the transition matters is included in Appendix D of this ASPE Briefing.

**Accounting Methods When Significant Influence is Present**

As indicated above, Section 3051 applies to investments subject to significant influence. The accounting method applied is dependent on the policy choice and whether the investment is in shares traded in an active market. The policy choices are summarized in the following chart:

- **Significant influence is present**
  - Shares not traded in an active market
    - Equity Method (Refer to Section 3051)
    - Cost Method (Refer to Section 3051)
  - Shares traded in an active market
    - Equity Method (Refer to Section 3051)
    - Fair Value Method (Refer to Section 3856)

**Reminder:** Applying the cost or equity method is a policy choice for investments subject to significant influence, investments in JCEs, and investments in subsidiaries. The guidance in Section 3051 may be applicable to different types of investment. To be clear: there is a separate policy choice for (a) significant influence, (b) JCEs and (c) subsidiaries. Therefore, different choices can be made for each; however, the same choice must be made within each of the three categories.

**Equity Method**

Paragraph 3051.04(a) defines the equity method as follows:

The equity method is a basis of accounting for investments whereby the investment is initially recorded at cost and the carrying value is adjusted thereafter to include the investor’s pro rata share of post-acquisition earnings of the investee, computed by the
consolidation method. The amount of the adjustment is included in the determination of net income by the investor, and the investment account of the investor is also increased or decreased to reflect the investor’s share of capital transactions and changes in accounting policies and corrections of errors relating to prior period financial statements applicable to post-acquisition periods. Profit distributions received or receivable from an investee reduce the carrying value of the investment.

**FAQ**

**Under the above definition of the equity method, the phrase “computed by the consolidation method” is used. What does that mean?**

In essence the term “computed by the consolidation method” means that the equity method requires similar adjustments when calculating the “equity pick-up” or adjustment as those that would occur if consolidation accounting were applied.

Specifically, paragraph 3051.11 requires the depreciation and amortization of the investee’s assets be based on the assigned costs of such assets at the date of acquisition (i.e., the fair value on the acquisition date). However, the portion of the difference between the investor’s cost and the amount of its underlying equity in the net assets of the investee that is similar to goodwill (equity method goodwill) is not amortized.

(See also paragraphs 3051.12-.13)

**FAQ**

**How does accounting for partnerships fit in?**

A partnership is a vehicle or structure, and not a category of accounting, although some often refer to the matter as “accounting for partnerships”. The appropriate accounting will depend on the nature of the partnership and the degree of influence or control the investor has over the partnership. It could be appropriate to apply the cost method, equity method, consolidation or to account for it as an interest in a joint arrangement representing rights to the individual assets and obligations for the individual liabilities relating to a JA.
**Cost Method**

Section 3051 defines the cost method as follows:

The **cost method** is a basis of accounting for investments whereby the investment is initially recorded at cost; earnings from such investments are recognized only to the extent received or receivable (see paragraph 3051.04(b)).

The cost method is the simplest method and generally means the amount paid or payable for the investment (or the fair value measurement of the consideration for a non-monetary transaction). In December 2016 amendments to Section 3051 which provide guidance on how to apply the cost method when recognizing subsidiaries, investments subject to significant influence, and other investments using the cost method.

**Initial Measurement**

- Cost is measured at the acquisition-date fair value of the consideration transferred, including measurement of any contingent consideration.
- When an investment subject to significant influence is acquired by an exchange of only equity interests, the acquisition-date fair value of the investee’s equity interests may be more reliably measurable than the acquisition-date fair value of the enterprise’s equity interests. If so, the enterprise must determine the fair value of the consideration transferred by using the acquisition-date fair value of the investee’s equity interests instead of the acquisition-date fair value of the enterprise’s equity interests transferred.
- When an interest subject to significant influence is acquired in two or more transactions, at the same or different dates, the cost of the investment is the sum of the cost of the separate transactions, and would include any transaction costs that may have been capitalized as part of the first transaction in accordance with Section 3856.
- The acquisition of an investment will generally involve some transaction costs. These range from a simple brokerage fee on a market-purchase of equity securities, to the significant legal and accounting fees that can be involved in more complex acquisition transactions. Acquisition costs, sometimes referred to as “transaction costs” which are incurred at acquisition are recognized as an expense. The exception expensing these items is for any costs to issue debt and equity securities (see Section 3856, Financial Instruments and Section 3610, Capital Transactions.)

**Subsequent Measurement**

When there is an indication of impairment, an investor must determine whether a significant adverse change has occurred during the period in the expected timing or amount of future cash flows from the investment. The following indicators of impairment were added to paragraph 3051.24 as part of the 2016 amendments:
an acquisition of an additional interest or sale of a portion of an interest in an investee for consideration paid or received that is less than the proportionate share of the carrying amount of the interest in an investee immediately before the acquisition or sale (see paragraph 3051.24(e))

• a dilution in an investor’s interest in an investee that indicates the expected amount of future cash flows from holding or selling the investment is less than the carrying amount of the investment immediately before the dilution (see paragraph 3051.24(f))

The amendments to Section 3051 issued in December 2016 are applied to annual financial statements relating to fiscal years beginning on or after January 1, 2018. The amendments may be applied prospectively as defined in paragraph 1506.05(g). Earlier application is permitted (see paragraph 3051.43).

Using Fair Value or Quoted Amount (Sometimes Referred to as the “Fair Value Method”)

Section 3051 and other Sections of ASPE define fair value as follows:

**Fair value** is the amount of the consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act (see paragraph 3051.04(d)).

All investments accounted for under Section 3856 are initially recorded at fair value. Section 3856 requires that equity instruments traded in an active market and derivatives be subsequently measured at fair value. It would not be consistent to have interests in subsidiaries and investments subject to significant influence measured using the cost method if they are traded in an active market. Therefore, controlled or significantly influenced investments that are traded in an active market cannot be accounted for using the cost method but may be accounted for at their quoted amounts or by using the equity method. In addition, the concept of fair value can also be relevant when determining the impairment of investments. However, a full discussion of the application of fair value and impairment is beyond the scope of this ASPE Briefing.

**Transactions Between the Investor and Investee**

Transactions between the investor and the investee fall into two main categories:

• initial contributions
• subsequent transactions

If the equity method is used, the accounting for subsequent transactions can be more complex since the subsequent transactions must be identified as either “upstream” (i.e., transactions where investee sells assets to the investor) or “downstream” (i.e., transactions where the investor sells assets to the investee).
The following chart summarizes the different types of transactions between the investor and investee:

**Initial Contributions**
If the initial contributions are in the form of cash there is little complexity. However, in some instances the contributions are tangible and intangible assets—with or without cash. Furthermore, at times, the investors are related parties before the arrangement is formulated. Therefore, as can be seen in the following chart, multiple standards may need to be reviewed to determine how to account for the initial contributions:

- **Measured at fair value**, provided the fair value is reliably measurable.
  - For non-monetary transactions, see Section 3831, *Non-monetary Transactions*, if applicable.
- **Follow Section 3840, Related Party Transactions.**
  - For non-monetary transactions, see Section 3831, *Non-monetary Transactions*, if applicable.
Appendix B of this ASPE Briefing provides some examples of the initial contribution to a joint arrangement.

**Subsequent Transactions**

Because subsequent transactions between the investor and investee are related-party transactions, the accounting follows the guidance in Section 3840, *Related Party Transactions* and Section 3831, *Non-monetary Transactions* if applicable.

If a related party transaction is not in the normal course of operations or does not represent a substantive change in ownership, the transaction is measured at the carrying amount. No gain or loss is recorded.

The following chart summarizes the accounting for subsequent transactions between the investor and investee that occur in the normal course of operations and are measured at the exchange amount:

<table>
<thead>
<tr>
<th>Nature of transaction</th>
<th>Investor Sells Assets to Investee “Downstream”</th>
<th>Investor Purchases Assets from Investee “Upstream”</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>An investor sells assets to an equity-accounted investee in the normal course of operations.</td>
<td>An investor purchases assets in the normal course of operations from an equity-accounted investee.</td>
</tr>
<tr>
<td>Accounting treatment</td>
<td>Any gain or loss shall be recognized in income at the time of the sale to the extent of the interests of the other non-related investors.</td>
<td>The investor shall not recognize its share of the profit or loss of the investee on the transaction until the assets are sold to a third party.</td>
</tr>
</tbody>
</table>

When an investor sells an asset to an investee in the normal course of operations and the transaction provides evidence of a reduction in the net realizable value or a decline in the carrying amount of the relevant asset, the investor shall recognize this decline by writing down that portion of the asset retained through its interest in the equity-accounted investee and recognize the full amount of any loss in income.

Appendix C provides some examples of transactions between the investor and investee using the equity method.

**Impairment**

Paragraph 3051.23 provides guidance on the need to assess investments for impairment:

At the end of each reporting period, an investor shall assess whether there are any indications that an investment may be impaired. When there is an indication of impairment, an investor shall determine whether a significant adverse change has occurred during the period in the expected timing or amount of future cash flows from the investment.
Reminder: The impairment assessment applies to all investments accounted for under the cost and equity methods.

The following steps summarize the guidance on impairment in paragraphs 3051.23-.27:

**Step 1.** Assess whether there are any indications that an investment may be impaired.

**Step 2.** When there is an indication of impairment, determine whether a significant adverse change has occurred during the period.

**Step 3.** When significant adverse changes are identified, reduce the carrying amount to the higher of:

(a) PV of cash flows expected from holding the investment discounted using a current market rate of interest appropriate for the asset; or

(b) the amount that could be realized by selling the investment at the balance sheet date.

Although a full discussion of the impairment of investments is beyond the scope of this ASPE Briefing, the following general reminders are provided:

- When an impairment is determined to exist, the investment can be written down directly or by using an allowance.
- Any impairment loss is recorded in net income.
- An impairment loss must be reversed if conditions change.

**Presentation and Disclosure**

The presentation requirements are included in paragraphs 3051.31-.33 which specify that certain items must be presented separately in the income statement and balance sheet. The disclosure requirements are included in paragraphs 3051.34-.38.
An interest in a subsidiary can be created by subscribing to the common shares of a new enterprise, purchasing a controlling interest in the shares of an existing enterprise (see Section 1582, Business Combinations) or through a contract or other means that conveys control.

Paragraph 1591.03 provides the following definitions:

**Subsidiary** is an enterprise controlled by another enterprise (the parent) that has the right and ability to obtain future economic benefits from the resources of the enterprise and is exposed to the related risks (see paragraph 1591.03 (a)).

**Control** of an enterprise is the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others (see paragraph 1591.03 (b)).

**FAQ**

What does “continuing power” mean in the definition of control?

Generally it means that the power is uninterrupted. However, judgment must be used to reach such a conclusion. As indicated in paragraph 1591.12 a “brief interruption of the power to determine strategic policies is not a loss of control. For example, a receiver appointed pursuant to a default by a subsidiary under a loan arrangement with a third party may seize a specific asset in satisfaction of the loan but permit the subsidiary to continue in business under the direction of the parent.”
Scope

Section 1591, *Subsidiaries*, as the name implies, addresses the accounting for subsidiaries (i.e., those investments where control exists). Its main guidance is on the assessment of control; the actual accounting for the investment is addressed in other standards. As a result, Section 1591 is closely related to the following Sections:

- Section 1582, *Business Combinations*, which sets out the basis of accounting for transactions by which businesses are acquired
- Section 1601, *Consolidated Financial Statements*, which describes the preparation of consolidated financial statements and also deals with combined financial statements
- Section 1602, *Non-controlling Interests*, which describes the accounting for a non-controlling interest in a subsidiary subsequent to the subsidiary’s acquisition
- Section 3051, *Investments*, which describes the accounting for subsidiaries where the cost or equity method is selected

Section 1591 applies to interests in other entities; the following exceptions are outside the scope of Section 1591:

- accounting for investments covered by other Sections (see Section 3051, *Investments*, Section 3056, *Interests in Joint Arrangements* and Section 3856, *Financial Instruments*)
- accounting by investment companies (see Accounting Guideline (AcG-18), *Investment Companies*)
- employer’s accounting for an employee benefit plan subject to the provisions of Section 3462, *Employee Future Benefits*
- accounting for a qualifying special-purpose enterprise by a transferor of financial assets or its affiliates, as set out in Appendix B in Section 3856, *Financial Instruments*; a transferor reports its rights and obligations related to the qualifying special-purpose enterprise according to the requirements of Section 3856
- accounting for an enterprise’s interests in a qualifying special-purpose enterprise, unless that enterprise has the unilateral ability to cause the enterprise to liquidate or to change the enterprise so that it no longer meets the conditions set out in Appendix B of Section 3856, *Financial Instruments*; if the enterprise is not consolidated, the enterprise reports its rights and obligations related to that enterprise in accordance with the applicable Section
- accounting for contractual arrangements between enterprises under common control. In its consolidated or non-consolidated financial statements, each such enterprise reports its rights and obligations related to another enterprise under common control in accordance with the applicable Section (e.g., leases)
Effective Date

As identified in the Introduction of this ASPE Briefing, Section 1591 is effective for annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted. Retrospective application is required—with some exceptions (see paragraph 1591.39).

Section 1591 was amended in December 2016 and the effective dates of these amendments vary so they are discussed separately. The following amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2017 and earlier application is permitted. These amendments are to clarify:

- that when an enterprise prepares non-consolidated financial statements, it is not required to identify and disclose information about subsidiaries controlled through contractual arrangements
- To clarify that the transitional provisions in Sections 1591 can only be applied to annual financial statements relating to the first fiscal year in which Section 1591 is applied and cannot be applied when an enterprise changes its accounting policy choice to consolidate its subsidiaries. That is, the relief provided in the transitional guidance is only available to enterprises transitioning to Section 1591 for the first time.

The second set of amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2018, and may be applied prospectively. Earlier application permitted. These amendments provide guidance on how to apply the cost method for subsidiaries as follows:

**Initial Measurement**

- Cost is measured at the acquisition-date fair value of the consideration transferred, including measurement of any contingent consideration
- When an investment in a subsidiary is acquired by an exchange of only equity interests, the acquisition-date fair value of the investee’s equity interests may be more reliably measurable than the acquisition-date fair value of the enterprise’s equity interests. If so, the enterprise must determine the fair value of the consideration transferred by using the acquisition-date fair value of the investee’s equity interests instead of the acquisition-date fair value of the enterprise’s equity interests transferred
- When an investment in a subsidiary is acquired in two or more transactions, at the same or different dates, the cost of the investment is the sum of the cost of the separate transactions
- When an enterprise and the subsidiary have a pre-existing relationship or other arrangement that existed before negotiations for the acquisition of the subsidiary began, or enters into an arrangement during the negotiations that is separate from the acquisition of the subsidiary, including the remuneration of employees or former owners of the
acquiree for future services or reimbursement of the acquiree or its former owners for paying the acquirer’s acquisition-related costs, then the requirements in Section 1582, Business Combinations, is applied

• Acquisition costs incurred are recognized as an expense, except for costs to issue debt and equity securities (see Section 3856, Financial Instruments and Section 3610, Capital Transactions)

• A bargain purchase gain on the purchase of a subsidiary is not recognized

• A previously-held investment is not remeasured in a step acquisition

• If the initial accounting for a subsidiary is incomplete by the end of the reporting period in which the acquisition occurs because of, for example, a working capital adjustment clause, the carrying amount must include a provisional amount. The amendments address the accounting for any provisional amounts in subsequent periods as well as provide guidance on any acquisitions that were incomplete prior to the applications of these amendments (see paragraphs 29B(b) and 39C of Section 1591)

Subsequent Periods

• Recognize earnings from subsidiaries only to the extent received or receivable

• At the end of each reporting period, the requirements on impairment in Section 3051 must be applied

• Contingent consideration must be remeasured when the contingency is resolved, on the same basis as required by Section 1582

• The provisional carrying amount, if any, of the interest in the subsidiary is to be adjusted in the period in which the provisional amounts are finalized and this measurement period must not exceed one year from the acquisition date

• Guidance on accounting for the interest when an ownership interest in a subsidiary decreases or increases in subsequent periods is addressed, i.e., sale or purchase of a portion of the interest or dilution

Disclosure

• Disclosures related to non-consolidated financial statements using the cost or equity method were clarified

A discussion on the transition is included in Appendix D of this ASPE Briefing.
Control
The following diagram can be used to determine whether control exists. It can be used as guidance; however, the sufficiency of rights and abilities must still be determined.

Note 1: An enterprise is presumed to control another enterprise when it owns, directly or indirectly, an equity interest that carries the right to elect the majority of the members of the other enterprise’s board of directors. These presumptions may be overcome by other factors (see paragraph 1591.09).

Refer to paragraphs 1591.16-.23 when applying this guidance.
FAQ
What is an example of control through means other than an equity interest?
An example would be a franchisor who, through the franchise contract, has “the continuing power to determine the franchisee’s strategic operating, investing and financing policies without the co-operation of others”.

FAQ
What does the scope exclusion related to contractual arrangements between enterprises under common control mean to me (see paragraph 1591.02(f))?
Contractual arrangements may sometimes seem to imply control between enterprises under common control. For example, a holding company owns an operating company and the primary shareholder of the holding company also owns a real estate company. There is a lease agreement between the operating company and real estate company or the real estate company and the holding company. The operating company is a subsidiary of the holding company. The question that may arise is whether the real estate company should be considered a subsidiary of the holding company or the operating company since the primary shareholder controls all the enterprises, directly or indirectly. However, since the enterprises are under the common control of the primary shareholder, it is not necessary to consider whether the holding company (or the operating company) should consolidate the real estate company.

In most small business structures, the probability of identifying a subsidiary controlled through a contractual arrangement where common control does not exist would be low.

Recognition and Presentation
In general terms, a subsidiary exists when the investor has control over the other enterprises. There are in essence two types of subsidiaries:

1. those controlled by way of an equity interest (including consideration of other factors, not just the number of votes)
2. those controlled through contractual arrangements
Paragraph 1591.24 (revised) indicates that an enterprise makes an accounting policy choice to:

a. consolidate **ALL** its subsidiaries
   OR
b. prepare non-consolidated financial statements and:
   i. account for investments controlled through voting interests, potential voting interests or a combination thereof using either the cost or equity method AND
   ii. account for investments controlled through contractual arrangements according to the nature of the contractual arrangements in accordance with the applicable Section (e.g., Section 3065, Leases, etc.)
   iii. account for investments controlled through voting interests, potential voting interests, or a combination thereof, in combination with contractual arrangements by accounting for the equity portion using the cost or equity method, and the contractual arrangements in accordance with the applicable Section (e.g., Section 3065, Leases, etc.).

This means that, if consolidation is selected, it must be done for **ALL** subsidiaries regardless of how control arises.

**Reminder:** FV is used rather than cost if the investment is in equity securities traded in an active market (see paragraph 1591.26).

The existence of control in a particular situation is a question of fact. The guidance in Section 1591 provides some indication of the factors to be considered in determining whether control exists in specific situations (see paragraphs 1591.11-.23).
FAQ

Is the common control exemption in the scope of Section 1591 (see paragraph 1591.02(f)) and the scope exception for related parties (see paragraph 1591.31) addressing the same concern?

No. The scope exemption at the beginning of Section 1591 makes it clear the standard does not deal with accounting for contractual arrangements between enterprises under common control. However, a contractual arrangement may be a factor in the assessment of control. If the investor is preparing consolidated or non-consolidated financial statements, the investor reports its rights and obligations related to another enterprise under common control in accordance with the applicable Section (e.g., if the contractual agreement which confers controls is a lease, then Section 3065 would apply).

Paragraphs 1591.30 and .31 do not refer or apply to common control. Paragraph 1591.31 addresses intercompany transactions:

The requirements of RELATED PARTY TRANSACTIONS, Section 3840, would not apply to intercompany transactions between the parent and subsidiaries controlled through means other than voting interests, potential voting interests, or a combination thereof, that would otherwise be eliminated on consolidation when:
(a) the enterprise is preparing non-consolidated financial statements; and
(b) control through means other than voting interests, potential voting interests, or a combination thereof, is the only basis of the relationship with the other party.

When an enterprise applies the cost or equity method, the requirements of Section 3840, Related Party Transactions apply to intercompany transactions that would otherwise have been eliminated on consolidation (see paragraph 1591.30). However, as indicated above, the requirements of Section 3840 do not apply to intercompany transactions between a parent and its subsidiaries controlled through means other than voting interests, potential voting interests, or a combination thereof, that would otherwise be eliminated on consolidation when:
• the enterprise is preparing non-consolidated financial statements
• control through means other than voting interests, potential voting interests, or a combination thereof, is the only basis of the relationship with the other party.

As mentioned, control is a matter of fact but requires significant effort to assess. The key issue is to assess control. If control exists, there are some policy choices to be made as to how the subsidiary is to be accounted for. A key consideration in the policy choice is often the cost of the subsequent accounting. For example, the cost to prepare consolidated
financial statements does not always exceed the benefits, if any, to the users of the financial statements. The following decision tree helps illustrate the decisions and the related references in the standard. The decision tree creates two branches by asking whether control of another enterprise exists through an equity interest. The branch on the left addresses those situations where a subsidiary exists through an equity interest and consolidated financial statements are being considered. The branch on the right addresses those situations where control may exist by means other than equity interests.

** You do not need to assess whether you control other enterprises through means other than equity interests.
Measurement

FAQ

How do I consolidate when an enterprise (the subsidiary) is controlled through rights other than equity interests?

In essence you combine the “parent” with the subsidiary measured at fair value on the day control is acquired (in accordance with Section 1582, Business Combinations), and a non-controlling interest is measured at 100% (or less if you own an equity interest) of the net book value of the subsidiary.

Disclosure

The disclosure requirements depend on whether the financial statements are consolidated or not. The references are provided below:

**Consolidated financial statements**

Paragraphs 1591.32-.35

*Note:* Disclosures required by other standards would also apply (e.g., if the contractual agreement which confers control is a lease, the disclosures in Section 3065 apply).

**Non-consolidated financial statements**

Paragraphs 1591.36-.38

*Note:* The disclosure ONLY refers to subsidiaries controlled through voting interests, potential voting interests, or a combination thereof, and does NOT require disclosure if control exists without an equity interest.

However, disclosures required by other standards apply (e.g., if the contractual agreement which confers control is a lease, the disclosures in Section 3065 apply).
PART E
Other Resources

The following is a list of additional useful resources on the topics discussed in this ASPE Briefing:

1. AcSB, **Consolidations, Joint Arrangements and Investments**—View the Accounting Standards Board webinar to understand the changes to the accounting for Subsidiaries and Joint Arrangements resulting from the issuance of Sections 1591 and 3056 (September 2014)
2. AcSB, **Subsidiaries: Background Information and Basis for Conclusions Section 1591** (March 2015)
3. AcSB, **Joint Arrangements Background Information and Basis for Conclusions Sections 3051 and 3056** (March 2015)
4. CPA Canada, **Financial Reporting Alert: Section 3051, Investments** (January 2015)
5. CPA Canada, **Financial Reporting Alert: Section 3056, Joint Arrangements** (January 2015)
6. CPA Canada, **Financial Reporting Alert: Section 1591, Subsidiaries** (May 2015)
7. CPA Canada, **Practitioner’s Pulse Webinar (February 2015)** on Joint Arrangements and Investments
8. CPA Canada, **Practitioner’s Pulse Webinar (June 2015)** on Subsidiaries
9. CPA Canada, **Guide to Accounting Standards for Private Enterprises**
10. AcSB Staff, **FYI Article—Joint Arrangements and Investments: Embrace the Changes**
11. AcSB Staff, **FYI Article—Consolidations: No More AcG-15 Headaches for Private Enterprises!** (December 2014)
12. AcSB Staff Financial Reporting Commentary, **Making Judgment Professional** (February 2013)
13. AcSB, **FYI Article—Clarifying the Cost Method: Subsidiaries and Investments** (November 2015)
15. AcSB, **Clarifications to Sections 1591 and 3056: Background Information and Basis for Conclusions** (December 2016)
16. AcSB, Subsidiaries and Investments—Sections 1591 and 3051: Background Information and Basis for Conclusions (December 2016)

17. AcSB, FYI Article—Accounting For Investments: Are You Ready For the Changes? (April 2017)

18. CPA Canada, Financial Reporting Alert, Subsidiaries, Investments and Interests in Joint Arrangements (July 2017)
APPENDIX A

An Example of the Equity Method

In accordance with the definition of the equity method, the amount of the investor’s pro rata share of post-acquisition earnings of the investee, is computed by the consolidation method. The following example will provide a non-complex illustration of the equity method as a refresher for the concepts only. Assume all amounts are material since the example is for illustration purposes.

The facts:

- Company A purchased 4,000 shares (40%) of Company B’s common stock on January 2, 20X2, for $200,000.
- Assume there is no contingent consideration or transaction costs.
- Company B’s 20X2 net income is $80,000.
- Company B paid dividends in 20X2 of $20,000 ($2 per share).
- Total shareholders’ equity of Company B at January 2, 20X2 is $300,000. Company B’s land with a book value of $50,000 has a fair value of $120,000. Its other capital assets have a net book value of $300,000 and a fair value of $350,000. The estimated remaining useful life of these other capital assets is 10 years. The fair value of the remaining identifiable assets and liabilities approximated book value at January 2, 20X2. The net book value of the remaining identifiable assets and liabilities is a net liability of $50,000.
- Assume that both Company A and Company B apply the taxes payable method.
The following computations illustrate the carrying amount of the investment at the end of the period for Company A.

**Computations for the Application of the Equity Method Applied by the Investor**

**Step 1: At acquisition, determine goodwill, if any.**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in 40% of the shares of Company B</td>
<td>$200,000</td>
</tr>
<tr>
<td>40% of the book value of net assets acquired (40% of $300,000)</td>
<td>$120,000</td>
</tr>
<tr>
<td>Excess of purchase price over book value of net assets acquired</td>
<td>$80,000</td>
</tr>
</tbody>
</table>

**Step 2: Company A allocation of purchase price:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>$200,000</td>
</tr>
<tr>
<td>Net assets of Company B at book value</td>
<td>$120,000</td>
</tr>
<tr>
<td>Additional amount assigned to land (($120,000 - $50,000 = $70,000) x 40%)</td>
<td>$28,000</td>
</tr>
<tr>
<td>Additional amount assigned to other capital assets (($350,000-$300,000 = $50,000) x 40%)</td>
<td>$20,000</td>
</tr>
<tr>
<td>Value of net assets acquired</td>
<td>$168,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>$32,000</td>
</tr>
</tbody>
</table>

**Step 3: Company A’s equity in the earnings of Company B is calculated as follows:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income of Company B</td>
<td>$80,000</td>
</tr>
<tr>
<td>Share of income ($80,000 x 40%)</td>
<td>$32,000</td>
</tr>
<tr>
<td>Additional depreciation ($50,000 x 40% = $20,000/10 year life)</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Equity pickup</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

**Investment, beginning of year**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>$200,000</td>
</tr>
<tr>
<td>Dividends (4,000 x $2)</td>
<td>(8,000)</td>
</tr>
<tr>
<td><strong>Investment, end of year</strong></td>
<td>$222,000</td>
</tr>
</tbody>
</table>

**Alternative calculation:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>$200,000</td>
</tr>
<tr>
<td>+ Income $80,000 x 40%</td>
<td>32,000</td>
</tr>
<tr>
<td>- Dividends ($20,000 x 40%)</td>
<td>(8,000)</td>
</tr>
<tr>
<td>- Depreciation ($50,000/10 x 40%)</td>
<td>(2,000)</td>
</tr>
<tr>
<td><strong>Investment, end of year</strong></td>
<td>$222,000</td>
</tr>
</tbody>
</table>
APPENDIX B
Examples of Initial Contributions for a Jointly Controlled Enterprise (JCE)—Accounted for Using the Equity Method

Initial Contribution of Capital Assets
Example 1—The accounting by the investor in a JCE for a contribution of capital assets with a carrying value < (less than) fair value and the treatment of a gain (ignoring income taxes).

On January 1, Tortly Ltd. (TL) entered into a joint arrangement agreement with two other unrelated corporations. A new corporation was set up and classified as a JCE. TL contributed capital assets with a fair value of $723,000 and a carrying value of $487,000. In return, TL received a one-third interest in the JCE and $123,000 in cash. Each of the other investors contributed $50,000 in cash and capital assets with a fair market value of $550,000. The JCE arranged a bank loan for $350,000 in order to finance its cash requirements.
Accounting for this transaction by TL under Sections 3051 (equity accounting) and new Section 3056:

The portion of the gain on the transfer of assets attributable to the other investors is included in income and calculated as follows:

**Calculation of the Gain on Transfer of Capital Assets at January 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of capital assets transferred by TL to JCE</td>
<td>$723,000</td>
</tr>
<tr>
<td>Carrying amount on TL's books</td>
<td>$487,000</td>
</tr>
<tr>
<td>Full gain on transfer of capital assets to JCE</td>
<td>$236,000</td>
</tr>
</tbody>
</table>

**Allocation of gain**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain attributable to TL's remaining interest in the JCE (1/3)</td>
<td>$78,667</td>
</tr>
<tr>
<td>Gain attributable to the investors' remaining interest (2/3)</td>
<td>$157,333</td>
</tr>
</tbody>
</table>

The journal entry to be recorded by TL is as follows:

- Investment in JCE $521,333
- Cash 123,000
- Gain on transfer of capital assets to JCE $157,333
- Capital assets (carrying value) 487,000

TL's investment in JCE is calculated as follows: $723,000 less cash of $123,000 less TL's gain of $78,667 as the gain is only recognized to the extent of the other investors (see paragraph 3051.14). The gain attributable to the portion TL still has as an interest in the JCE is amortized to income on the same basis as the related capital asset (now in JCE), increasing the investment balance.

**Note:** Under Sections 3051/3056 the fact that the JCE arranged for financing does not change the recording of this transaction. A different calculation would have been needed under Section 3055. A summary of the accounting for this same transaction under Section 3055 is included in Appendix D of this ASPE Briefing.

**Example 2—The accounting by the investor in a JCE for a contribution of capital assets with a carrying value > (greater than) fair value and the treatment of a loss (ignoring income taxes)**

On January 1, as its capital contribution to a JCE, Gravel Ltd. (GL) contributed capital assets with a fair value of $480,000 and a carrying value of $840,000. In return, GL received a 25% interest in the JCE and $380,000 in cash.
The capital assets are not written down to fair value prior to the transfer. (Reminder: This situation can occur because the impairment test for capital assets makes the assessment by comparing the net recoverable amount to the carrying amount, not the fair value.)

**Scenario A**

In Scenario A, there is sufficient evidence of a decline in the carrying value of the capital assets.

Assuming the transaction provides evidence of a decline in the carrying value of the asset, 100% of the loss is recognized.

Under paragraph 3051.14 the required journal entry is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in JCE (FV of asset $480,000 - cash of $380,000)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Loss [(100%) ($480,000 - $840,000)]</td>
<td>360,000</td>
</tr>
<tr>
<td>Cash</td>
<td>380,000</td>
</tr>
<tr>
<td>Capital assets (carrying value)</td>
<td>$840,000</td>
</tr>
</tbody>
</table>

**Scenario B**

In Scenario B, there is insufficient evidence of a decline in the carrying value of the capital assets.

When there is insufficient evidence of a decline in the carrying value of the capital assets, only 75% of the loss is recognized.

**Calculation of the Loss on Transfer of Capital Assets as at January 1**

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of capital asset transferred by GL to JCE</td>
<td>$480,000</td>
</tr>
<tr>
<td>Carrying amount on GL's books</td>
<td>840,000</td>
</tr>
<tr>
<td>Full loss on transfer of capital assets to JCE</td>
<td>($360,000)</td>
</tr>
</tbody>
</table>

**Allocation of loss**

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss attributable to the portion of GL's remaining interest in the JCE (1/4)</td>
<td>$90,000</td>
</tr>
<tr>
<td>Loss attributable to the other investors' remaining portion (3/4)</td>
<td>270,000</td>
</tr>
<tr>
<td>Full loss on transfer of assets to JCE</td>
<td>$360,000</td>
</tr>
</tbody>
</table>

As a result, the capital asset is being transferred at a value of $570,000 [FV $840,000 - (75% of the loss of $360,000 or $270,000)]. This means the investment in the joint arrangement will be recorded at $190,000 ($570,000 - less the cash received of $380,000).
Under paragraph 3051.14 the required journal entry is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in JCE</td>
<td>$190,000</td>
</tr>
<tr>
<td>Loss [(75%) ($480,000 - $840,000)]</td>
<td>270,000</td>
</tr>
<tr>
<td>Cash</td>
<td>380,000</td>
</tr>
</tbody>
</table>

Capital assets (carrying value) $840,000

**Note:** 25% of the loss will be recognized as the asset is depreciated.
APPENDIX C

Examples of Transactions between Investor and Investee—Accounted for Using the Equity Method

The following example will serve to illustrate the application of the equity method when various consolidation adjustments are required.

On December 31, 20X1, B Ltd. (B) acquires 40% of the voting shares of C Inc. (C) for $400,000. At that time, the carrying value of C’s net assets was $900,000. All the assets and liabilities of C had fair values equal to their carrying values except for some equipment which had a fair value $100,000 greater than its carrying value. The estimated remaining useful life of the equipment was 10 years. B’s 40% share ownership gives the company significant influence over the operations of C.

For the year ended December, 31, 20X2, the income statements of the two companies were as follows (B has not recorded any investment income for the year 20X2):

<table>
<thead>
<tr>
<th></th>
<th>B Ltd.</th>
<th>C Inc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$980,000</td>
<td>$560,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>$520,000</td>
<td>$310,000</td>
</tr>
<tr>
<td>Other expenses</td>
<td>210,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Income taxes</td>
<td>100,000</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total expenses and taxes</strong></td>
<td><strong>$830,000</strong></td>
<td><strong>$470,000</strong></td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td><strong>$150,000</strong></td>
<td><strong>$90,000</strong></td>
</tr>
</tbody>
</table>
During the year ended December 31, 20X2, C sold merchandise to B (upstream) for $140,000. This merchandise had cost $70,000. One half of the merchandise, with an unrealized profit of $35,000, remains in the inventories of B on December 31, 20X2.

The required calculation of B’s investment income under the equity method is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>C’s net income</td>
<td>$90,000</td>
</tr>
<tr>
<td>Unrealized profits in B’s inventories</td>
<td>(35,000)</td>
</tr>
<tr>
<td>Fair value amortization of equipment ($100,000 ÷ 10)</td>
<td>(10,000)</td>
</tr>
<tr>
<td>C’s realized income</td>
<td>$45,000</td>
</tr>
<tr>
<td>B’s ownership percentage</td>
<td>40%</td>
</tr>
<tr>
<td><strong>Investment income</strong></td>
<td>$18,000</td>
</tr>
</tbody>
</table>

Using this result, B’s income statement is prepared as follows:

**B Ltd.**

**Income Statement**

**Year ended December 31, 20X2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$980,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>520,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>$460,000</td>
</tr>
<tr>
<td>Investment income</td>
<td>18,000</td>
</tr>
<tr>
<td>Other expenses</td>
<td>210,000</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Total expenses and taxes</strong></td>
<td>$310,000</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$168,000</td>
</tr>
</tbody>
</table>

Note: B’s income statement is unchanged except for the inclusion of investment income representing its share of C’s results. This illustrates the point that intercompany sales do not influence the equity method results except to the extent that some of the resulting profits are unrealized.

Note: The unrealized profit also has tax consequences. However, these consequences have not been shown here to keep the complexity to a minimum. The tax consequences will depend on whether the future income tax method or taxes payable method is selected as a policy choice.
# APPENDIX D

Summary of Key Changes and Transition Guidance

## Key Changes to Section 3056, *Interests in Joint Arrangements* and Section 3051, *Investments*, (with notations for the December 2016 amendments when appropriate)

The following chart summarizes the key changes by comparing existing Section 3055 to the new Section 3056, along with the amendments made to Section 3051:

<table>
<thead>
<tr>
<th>Replaced Section 3055, Interests in Joint Ventures</th>
<th>New Section 3056, Interests in Joint Arrangements</th>
<th>Amended Section 3051, Investments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effective date</strong></td>
<td>This new Section is effective for annual financial statements for fiscal years beginning on or after January 1, 2016. Earlier adoption is permitted but, if applied early, the enterprise must disclose this fact and apply amended paragraphs .14-.17 of Section 3051, Investments, at the same time.</td>
<td>The amendments to Section 3051 (i.e., paragraphs 3051.14-.17), are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2016. Early adoption is permitted, but Section 3056 must be applied at the same time.</td>
</tr>
<tr>
<td><strong>Terms</strong></td>
<td>“joint ventures”</td>
<td>“joint arrangements”</td>
</tr>
<tr>
<td></td>
<td>“joint venturer”</td>
<td>“investor in a joint arrangement”</td>
</tr>
<tr>
<td><strong>Scope</strong></td>
<td>Provides guidance on the accounting for interests in joint ventures.</td>
<td>No change in scope from Section 3055 except for the change in term from joint ventures to joint arrangements.</td>
</tr>
<tr>
<td>Replaced Section 3055, Interests in Joint Ventures</td>
<td>New Section 3056, Interests in Joint Arrangements</td>
<td>Amended Section 3051, Investments</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
<td>--------------------------------------------------</td>
<td>----------------------------------</td>
</tr>
</tbody>
</table>
| **Accounting policies for subsequent measurement and presentation** | Depends on the type of joint arrangements which include:  
• jointly controlled operation (JCO).  
• jointly controlled asset (JCA).  
• jointly controlled enterprise (JCE)  
The following accounting methods may be applied:  
• cost method (refers back to Section 3051)  
• equity method (refers back to Section 3051)  
• recognition of the interest in the individual assets, obligations, revenue and expenses of the joint arrangement | Policy choice may differ for each of the investment types:  
• unconsolidated subsidiaries  
• investments subject to significant influence  
• interests in the net assets of a joint arrangement  
The accounting policy choice to apply either the equity method or the cost method previously stated that the same choice must be made for all investments within the scope of Section 3051. This wording was amended to require the same choice be made for all investments subject to significant influence and removes any implication that it applies to other investments within the scope of Section 3051. |
| **Accounting for contributions to the joint arrangement** | Defer and amortize most gains on initial contributions. | The guidance from Section 3056 has been added.  
Section 3051 now contains all guidance for accounting for contributions for investments measured using the equity method. |
| **Impairment guidance** | Includes impairment guidance. | Guidance on impairment exists and was unchanged. (Amended in December 2016 to include additional impairment indicators). |
| **Depreciation** | Includes guidance on depreciation. | Guidance on depreciation formerly in Section 3055 remains unchanged in Section 3051. |
New Guidance on the Accounting for Contributions
For contributions to a joint arrangement, the requirement in Section 3055 to defer and amortize the portion of a gain that does not relate to the amount of cash received or the fair value of other assets received has been removed from Section 3056 because it did not meet a cost/benefit test. The AcSB received feedback from preparers and users of the financial statements of private enterprises that this deferral added additional complexity to the accounting and was not well understood.

Under Section 3056, any gain or loss that occurs will be recognized in income at the time of the transfer to the extent of the interests of the other non-related investors.

Examples of Joint Arrangements—Initial Contribution of Capital Assets
Example 1: The accounting by an investor in a JCE for a contribution of capital assets with a carrying value < (less than) fair value and the treatment of a gain (ignoring income taxes).

Note: This example is the same as the one in Appendix B plus it presents the accounting under Section 3055.

Under Section 3055 (old standard)
On January 1, Tortly Ltd. (TL) entered into a joint arrangement agreement with two other unrelated corporations and a new corporation was set up. TL contributed capital assets with a fair value of $723,000 and a carrying value of $487,000. In return, TL receives a one-third interest in the joint arrangement and $123,000 in cash. Each of the other investors contributed $50,000 in cash as well as capital assets with a fair market value of $550,000. The joint arrangement arranged a bank loan for $350,000 in order to finance its cash requirements.
The portion of the gain on the transfer of assets attributable to the other investors is $157,333 \([(2/3) ($723,000 - $487,000)]. The portion to be included in income would be calculated as follows:

**Calculation of the Gain on Transfer of Capital Assets as at January 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of capital asset transferred by TL to JA</td>
<td>$723,000</td>
</tr>
<tr>
<td>Carrying amount on TL's books</td>
<td>$487,000</td>
</tr>
<tr>
<td>Full gain on transfer of assets to JA</td>
<td>$236,000</td>
</tr>
</tbody>
</table>

**Allocation of the gain**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain attributable to the portion TL still has an interest in</td>
<td>$78,667</td>
</tr>
<tr>
<td>through the JA</td>
<td></td>
</tr>
<tr>
<td>Gain attributable to the other investors</td>
<td>$157,333</td>
</tr>
<tr>
<td>Total</td>
<td>$236,000</td>
</tr>
</tbody>
</table>

**A portion of the gain attributable to TL is taken into income because cash is received by TL**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash consideration received by TL</td>
<td>$123,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Some of the cash received represents borrowing by the JA</td>
<td></td>
</tr>
<tr>
<td>Cash from other investors (2 × $50,000)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Cash taken back</td>
<td>($123,000)</td>
</tr>
<tr>
<td>TL's portion</td>
<td>($23,000) × 1/3</td>
</tr>
<tr>
<td>Fair value of the consideration received</td>
<td>$115,333</td>
</tr>
</tbody>
</table>

**Carrying value of asset considered to be “partly sold”**

This amount is determined by applying the ratio of the consideration received over the fair value of the assets transferred to the JA, to the carrying value of the assets.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$115,333/723,000 × 487,000</td>
<td>$77,686</td>
</tr>
<tr>
<td>Gain taken to income at time of transfer ($115,333 - $77,686)</td>
<td>$37,647</td>
</tr>
<tr>
<td>Remaining portion to be deferred and amortized over the life of</td>
<td>$119,686</td>
</tr>
<tr>
<td>the capital asset.</td>
<td></td>
</tr>
<tr>
<td>($157,333 less $37,647)</td>
<td></td>
</tr>
</tbody>
</table>

The deferred gain is $119,686, the difference between the total gain to be recognized of $157,333 and the $37,474 that is included in income.

The initial value of the investment in the JCE account is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying value of capital assets</td>
<td>$ 487,000</td>
</tr>
<tr>
<td>Gain that can be recognized [(2/3)($723,000 - $487,000)]</td>
<td>157,333</td>
</tr>
<tr>
<td>Cash received</td>
<td>(123,000)</td>
</tr>
<tr>
<td>Cost of initial investment</td>
<td>$ 521,333</td>
</tr>
</tbody>
</table>
The journal entry to be recorded by TL would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in joint venture</td>
<td>$521,333</td>
</tr>
<tr>
<td>Cash</td>
<td>123,000</td>
</tr>
<tr>
<td>Deferred gain ($157,333 – $37,647)</td>
<td>$119,686</td>
</tr>
<tr>
<td>Gain on transfer of capital assets to the joint venture</td>
<td>37,647</td>
</tr>
<tr>
<td>Capital assets (carrying value)</td>
<td>487,000</td>
</tr>
</tbody>
</table>

**Under Sections 3051 (equity accounting) and 3056 (new standards)**

The total gain on the transfer of assets is $236,000, of which $157,333 is attributable to the other investors and is to be included in income, is calculated as follows:

*Calculation of the Gain on Transfer of Capital Assets as at January 1*

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of capital assets transferred by TL to JCE</td>
<td>$723,000</td>
</tr>
<tr>
<td>Carrying amount on TL’s books</td>
<td>487,000</td>
</tr>
<tr>
<td>Full gain on transfer of assets to JCE</td>
<td>$236,000</td>
</tr>
</tbody>
</table>

Allocation of the gain

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain attributable to the portion TL still has an interest in through the JA</td>
<td>1/3 $78,667</td>
</tr>
<tr>
<td>Gain attributable to the other investors</td>
<td>2/3 157,333</td>
</tr>
<tr>
<td></td>
<td>$236,000</td>
</tr>
</tbody>
</table>

The journal entry recorded by TL is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in JCE</td>
<td>$521,333</td>
</tr>
<tr>
<td>Cash</td>
<td>123,000</td>
</tr>
<tr>
<td>Gain on transfer of capital assets to JCE</td>
<td>$157,333</td>
</tr>
<tr>
<td>Capital assets (carrying value)</td>
<td>487,000</td>
</tr>
</tbody>
</table>

**Comparison:** The significant difference between the old and new/amended standards is illustrated by taking the same facts under Section 3055, applying Section 3056 and seeing the measurement of the deferred gain in the journal entries.

**Transition Guidance for Section 3051**

The transition guidance is comprehensive.

Section 3051: Paragraph 3051.14-.17 may be applied prospectively as defined in Section 1506, *Accounting Changes.*
Transition Guidance for Section 3056
The transition guidance depends on the change being made. It can be a change from the proportionate consolidation method to the cost/equity method or from the cost/equity method to recording individual assets and liabilities. Because retrospectively restating investments in joint arrangements would not always meet the cost/benefit test, simplified transitional provisions and choices have been provided.

The guidance can be summarized as follows:

1. **Proportionate consolidation method to cost/equity method**
   - Recognize investment in the joint arrangement as at the beginning of the earliest period presented.
   - Measure investment as the aggregate of the carrying amounts of assets and liabilities previously proportionately consolidated.

2. **Cost/equity method to individual assets and liabilities**
   - Choice of:
     - **Choice #1**: full retrospective restatement
     - **Choice #2**: using the carrying amounts in financial statements of the joint arrangement
     - **Choice #3**: using the fair value of the assets and liabilities

As indicated, where the transition results in a move from proportionate consolidation to the cost or equity method, an investor recognizes its investment in the joint arrangement as at the beginning of the earliest period presented. That initial investment is measured as the aggregate of the carrying amounts of the assets and liabilities the investor had previously proportionately consolidated.

When the transition results in a move from the cost or equity method to recognizing the investor’s interests in the individual assets and obligations for individual liabilities of a joint arrangement, an investor has the three choices mentioned above. The three choices can be described as follows:

**Choice #1**: Make a full retrospective restatement in accordance with Section 1506, Accounting Changes

**Choice #2**: Use the carrying amounts of the assets and liabilities in the financial statements of the joint arrangement at the beginning of the fiscal year immediately preceding the date at which Section 3056 is first applied.

**Choice #3**: Use the fair values of the assets and liabilities of the joint arrangement at the beginning of the fiscal year immediately preceding the date at which Section 3056 is first applied.
In both Choice #2 and Choice #3, the investor recognizes any difference between the net amount of the assets and liabilities of the joint arrangement included in its balance sheet and the amount of any previously recognized interests in the joint arrangement as an adjustment to opening retained earnings.

**FAQ**

**The revisions to Section 3051 (paragraphs 3051.14-.17) may be applied prospectively. Why did the AcSB say “may”, therefore allowing prospective or retrospective application? Is prospective application permitted for Section 3056?**

Section 3051 permits prospective application because the AcSB recognizes that retrospective application of the changes may result in costs to preparers that do not meet a cost/benefit test, or may be impractical.

Prospective application for Section 3056 is permitted through use of the transitional provisions, and is discussed in the Background Information and Basis for Conclusions Section 3056, paragraph 49:

One respondent to the Exposure Draft suggested that retrospective application of Section 3056 be required when the information is available. The AcSB discussed this option when creating the transitional provisions but concluded that retrospective application or the use of the special transition provisions should be a free choice. A free choice is consistent with the approach to exceptions to retrospective application in FIRST-TIME ADOPTION, Section 1500. Also, in many cases, the information to do retrospective application may be available, but the amount of effort and cost to use this information may not meet a cost/benefit test. The AcSB approved the transitional provisions substantially as exposed.

Section 3056 does not directly permit prospective application but provides a choice to use the special transitional provisions or retrospective application.

(See Background Information and Basis for Conclusions Section 3056, paragraphs .47-.49)

**Section 1591, Subsidiaries**

The issuance of Section 1591, Subsidiaries was completed with the removal of AcG-15, Consolidation of Variable Interest Entities.

AcG-15, Consolidation of Variable Interest Entities was a “rules-based” standard that was considered complex and difficult to understand and apply in practice. The purpose of the Guideline was to ensure consolidation of entities where there was exposure to the risks and
benefits of an enterprise that might otherwise be “off balance sheet”. When such an enterprise exists it could be considered misleading to not include the assets, liabilities, revenue and expenses.

One of the significant changes is the inclusion of factors to consider when determining whether control of another enterprise is obtained through rights other than equity interests. New guidance on rights designed to protect the interest of the enterprise is provided to distinguish rights that provide control from those that protect an enterprise’s interest in another enterprise but do not confer control.

Upon consultation with those preparing general purpose financial statements, it was felt that even if a variable interest enterprise existed, most private enterprises prepared non-consolidated financial statements, thus AcG-15 did not result in consolidation. However, guidance was needed for those situations where consolidation was appropriate and useful. The goal was to provide a single standard for the accounting guidance for subsidiaries. This was explained in the Background Information and Basis for Conclusions Section 1591, paragraph 19:

**One standard for subsidiaries**

The objective for issuing Section 1591 was to improve the usefulness of consolidated financial statements by developing guidance to apply to situations in which it has proved difficult to assess control in practice. New guidance was added to enable enterprises to evaluate whether contractual arrangements confer control over another enterprise and the ability to obtain future economic benefits from it. The AcSB did not want to modify the voting control model as it has been working well in practice. Therefore, the definition of control and a subsidiary remains unchanged, and the new guidance provides additional information on when enterprises are controlled through mechanisms other than equity interests.

Therefore, the complexities of AcG-15 are gone, but the principle of considering consolidation based on control still exists.

**Key Changes**

The key change is that AcG-15 has been removed and Section 1591, Subsidiaries replaces the existing Section 1590, Subsidiaries. The following changes in Section 1591 have been identified:

- Includes additional guidance that requires the application of professional judgment to determine when control is obtained through means other than equity interests.
- Points out that control may exist through contractual arrangements that confer on the enterprise the right and ability to obtain future benefits of, and be exposed to the risk from, the other enterprise.
• Indicates that contractual arrangements come in various forms, such as supply arrangements, management contracts, lease agreements, licence agreements, royalty contracts, other sales contracts and finance arrangements.
• Indicates that professional judgment must be used when evaluating whether contractual rights are sufficient to give an enterprise control over another enterprise.
• Identifies circumstances an enterprise could consider when assessing control (e.g., the degree of involvement in and decisions made at inception in determining the purpose and design of the other enterprise).
• The principle of considering whether control exists has not changed, so technically the concept of “variable interest entities” still exists, but this terminology is not used in Section 1591 to describe those subsidiaries that are controlled through rights other than equity interests.

The December amendments provided guidance on the application of the cost method.

**Disclosure**
The requirement in AcG-15 for a reporting enterprise to disclose significant restrictions on access to the assets of subsidiaries has been carried forward into Section 1591 for application by enterprises preparing consolidated financial statements.

**Transition Guidance for Section 1591**
To minimize the work required, transition relief has been provided for enterprises that prepared consolidated financial statements previously under Section 1590 and for those that choose to prepare consolidated financial statements for the first time when applying Section 1591.

It is important to note that this transition relief is only provided when you apply Section 1591 for the first time. (Clarified with December 2016 amendments.)

**Consolidating a Previously Unconsolidated Subsidiary (paragraph 1591.42)**
In the situation where an enterprise is consolidating a subsidiary that was not consolidated previously, the transition rules provide a choice of method to measure the assets, liabilities and non-controlling interests in each previously unconsolidated enterprise on a subsidiary-by-subsidiary basis when the information is available. The choices are:

**Choice #1:** Apply the acquisition method in Section 1582, Business Combinations

**Choice #2:** Use the carrying amounts of the assets and liabilities of the previously unconsolidated enterprise. The carrying amounts will be those at the beginning of the fiscal year immediately preceding the date at which Section 1591 is applied for the first time.
When applying either of these options, Section 1591 permits an enterprise to measure any item of property, plant and equipment at its fair value at the beginning of the comparative period. This is consistent with the option provided in Section 1500, First-time Adoption.

In addition, if Choice #1 is selected, and the enterprise being consolidated for the first time does not have financial information prepared in accordance with ASPE and lacks the information to do so, Section 1591 provides some specific guidance. It permits the enterprise to measure the assets, liabilities and non-controlling interest by applying the acquisition method in accordance with Section 1582, Business Combinations without the recognition of any goodwill and intangible assets as of the beginning of the comparative period.

Choice #1, the acquisition method, results in the most complete set of consolidated financial statements but may be time consuming and costly. Choice #2 provides relief from the cost to comply.

**Deconsolidating a Previously Consolidated Subsidiary (paragraph 1591.46)**

When applying this Section for the first time and the enterprise is no longer required to consolidate a subsidiary which was previously consolidated, the enterprise must measure its interest as the aggregate of the carrying amounts of the assets, liabilities, and non-controlling interest that were previously consolidated. Therefore, the enterprise must determine the interest in the enterprise as at the beginning of the fiscal year immediately preceding the date Section 1591 is applied for the first time.

The enterprise must also test the net investment for impairment in accordance with Section 3050, Investments at the beginning of the immediately preceding fiscal year and account for other rights and obligations in accordance with the applicable Sections.

If the interest in the other enterprise was obtained after the beginning of the immediately preceding period and before Section 1591 was applied for the first time, the date the interest was obtained is used.

At this date, the enterprise measures that interest as the aggregate of the carrying amounts of the assets, liabilities and non-controlling interests the enterprise had previously consolidated, including any goodwill arising from the acquisition and uses this balance as the deemed cost. In addition, the enterprise:

- tests the net investment for impairment in accordance with Section 3051, Investments
- accounts for other rights and obligations in accordance with the applicable Section(s), such as a lease or a financial liability
Transition Adjustments
The actual adjustments upon transition will depend on the nature of the investments, the prior policy followed, the selection of any new policy choices, and the transition options chosen. If there are no changes after the completion of the appropriate analysis, the transition will be simple. If there are many investments, and the most complex choice is made (i.e., the choice of retrospective application, with restatement), any measurement changes can be seen as falling into three components for financial statement presentation purposes:

1. **Opening Adjustment:** The cumulative adjustments of any measurement changes at the first day of the comparative financial statements (i.e., the “transition date”). This cumulative adjustment will be presented as an adjustment to retained earnings at the beginning of the period for the earliest comparative financial statement presented. It will also be recorded in the accounting records, including an adjustment to retained earnings, in the year Sections 3056 and 1591 and the amendments to Section 3051 are adopted.

2. **Comparative Adjustment:** These adjustments, if any, to the amounts presented on the comparative financial statements will also be recorded in the accounting records, including an adjustment to retained earnings, in the year Sections 3056 and 1591 and the amendments to Section 3051 are adopted.

3. **Current Adjustment, if needed:** These are the adjustments, if any, to the amounts presented in the current year. If the enterprise adopts Sections 3056 and 1591 and the amendments to Section 3051 at the beginning of the current period, no adjustments to accounting records will be needed at the end of the year.

The measurement adjustments for the retrospective application of Sections 3056 and 1591, and the amendments to Section 3051, if any, will be recorded in the accounting records in the year of adoption. For presentation purposes, there must be restatement except in rare circumstances when it is impracticable to do so (see paragraphs 1506.14-18).
For example, for an enterprise with a December year-end the summary of the three parts is as follows:

| Component #1: Opening Adjustment — adjustment to opening retained earnings at January 1, 2015 | xxxxx |
| Component #2: Comparative Adjustment — restatement of 2015 financial statement accounts | xxxxx |
| Component #3: Current Adjustment — recording of amounts in accordance with Sections 3056 and 1591, and the amendments to Section 3051, if not done within the 2016 year | xxxxx |

In order to determine the adjustments, the adoption date and the policy choice within Sections 3056 and 1591 and the amendments to Section 3051, must be understood along with any exceptions that will be applied in accordance with the transition guidance.

In some cases, the financial statements will change significantly because the type of investments may change the basis of measurement and presentation. In many cases, however, the change is expected to be minimal. The preparer of the financial statements should consider the users of the financial statements and the costs to comply with the many policies and transition choices that must be made.
FAQ

Is it expected that the adoption of Section 1591 will have a significant impact on my financial statements?

If you prepare non-consolidated financial statements: The adoption of Section 1591 will not have any effect on your financial statements.

Section 1591 retains the accounting policy choice to account for subsidiaries using the cost or equity method. Financial statements prepared using one of these accounting policies must be labelled as being prepared on a non-consolidated basis. Non-consolidated financial statements include the investments in subsidiaries that are controlled through voting interests, potential voting interests or a combination of both. However, entities that are controlled through contractual arrangements (or by contractual arrangements in combination with voting or potential voting interests) are not recognized as investments in subsidiaries in non-consolidated financial statements. Consequently there is no change in recognition, measurement or presentation for non-consolidated financial statements.

Section 1591 requires that the notes to the financial statements include a listing and description of significant subsidiaries controlled through voting interests, potential voting interests, or a combination thereof, including their names, carrying values and the proportion of ownership interests held in each subsidiary. There is no requirement to identify or provide any information about entities that are controlled through contractual arrangements, or by contractual arrangements in combination with voting or potential voting interests. As a result, there is also no change in disclosure requirements for non-consolidated financial statements.

If you prepare consolidated financial statements, it depends on whether you have control over other enterprises through contractual rights.

The guidance on identifying such subsidiaries has changed significantly from that in AcG-15 which provided very detailed guidance on identifying a Variable Interest Entity (VIE) but had been problematic to apply in practice. The new guidance in Section 1591 is less prescriptive and requires the use of judgment to determine when control is obtained through means other than equity interests. This guidance includes a description of when an enterprise has control through contractual rights and the circumstances an enterprise could consider when determining control while using professional judgment. As a result of
the change in the guidance, it is possible that certain enterprises not previously consolidated could now be required to be consolidated—and that some other enterprises that were consolidated previously may no longer qualify as subsidiaries.

So, at first glance it might seem that you may need to assess all contracts and relationships to determine whether there are any possible control relationships. But remember, Section 1591 does not deal with accounting for contractual arrangements between enterprises under common control, so that may exclude some potential control relationships.

If you control another organization, by any means, presumably, you know it! So it should not be a hunt in the dark.

**FAQ**

In the transition guidance for Section 1591, one of the options when preparing consolidated financial statements for the first time is to apply the acquisition method in accordance with Section 1582 without the recognition of any goodwill and intangible assets as of the beginning of the comparative period. Why is this option included?

It is an option to simplify the transition and recognize the practical constraints in the application of consolidation retrospectively. It recognizes that some enterprises that choose to prepare consolidated financial statements for the first time when applying the new standard might have subsidiaries that have not prepared financial information in accordance with ASPE before and may lack the information to do so.

The AcSB excluded goodwill and intangible assets because internally generated goodwill and intangible assets would not otherwise have been reported, and it would be difficult to distinguish between assets that were subject to acquisition accounting and those that were internally generated.

See FYI Article—Consolidations: No More AcG-15 Headaches for Private Enterprises! (Link provided in Part E of this ASPE Briefing)
Implications of the Changes
It is important to anticipate any impact from the changes discussed in this ASPE Briefing on key ratios or common performance metrics. For example, debt covenants, bonus calculations and other payouts may change.

Things to Remember When Transitioning
Identify investments and READ the relevant standards (see Appendix E).

Consequential Amendments
The summary of significant consequential amendments as a result of these new Sections and amendments includes:

• Section 1500, First-time Adoption—to allow an investor adopting Part II for the first time to apply the transitional provisions from Sections 3051 and 3056
• Section 1506, Accounting Changes—to exempt the accounting policy choice related to JCEs from meeting the relevance and reliability criterion
• Section 1520, Income Statement—to require income from investments in joint arrangements accounted for using the cost or equity method be presented separately on the face of the income statement
• Section 1521, Balance Sheet—to require investments in joint arrangements accounted for using the cost or equity method be presented separately on the balance sheet
• Section 3831, Non-Monetary Transactions—to refer to guidance in Section 3051, Investments for the accounting for gains or losses from non-monetary transactions

Additional consequential amendments were issued as a result of the December 2016 amendments. It is important to always work with the current version of the CPA Canada Handbook—Accounting.
APPENDIX E
Accounting for Investments—Points to Remember

Obtain an understanding of the various types of investments and interests in other entities.

**READ** the relevant standard:
- Section 3856, *Financial Instruments*
- Section 3051, *Investments*
- Section 3056, *Interests in Joint Arrangements*
- Section 1591, *Subsidiaries*

**Document** the nature of all investments/interests and the accounting policies selected, when appropriate.

**Develop** the note disclosure for significant accounting policies.

**Prepare the data for the appropriate presentation and disclosure matters**

**Income Statement**

Ensure the income from investments is presented separately on the face of the income statement, separating income from:

(i) **non-consolidated subsidiaries and joint arrangements accounted for using the cost or equity method, showing separately:**
   - income from investments measured using the equity method
   - income from all other investments in non-consolidated subsidiaries and in joint arrangements accounted for using the cost method

(ii) **all other investments, showing separately:**
   - income from investments measured using the cost method
   - income from investments measured using the equity method
   - income from investments measured at fair value.
Balance Sheet

Separate current investments from long-term investments

Separately present the following:

- Investments in non-consolidated subsidiaries and joint arrangements accounted for using the cost or equity method, showing separately:
  1. investments measured using the cost method
  2. investments measured using the equity method
  3. investments measured at fair value

- All other investments showing separately:
  1. investments measured using the cost method
  2. investments measured using the equity method
  3. investments measured at fair value.

Cash Flow Statement

Ensure the cash flow statement presents the following:

- Investments accounted for using the equity method:
  1. When the indirect method is used, the equity “pickup” is a non-cash item in the cash flow from operations.
  2. When an investment in an enterprise is accounted for using the equity method, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee (e.g., to dividends and advances).

- When an enterprise has an interest in a JA and accounts for that interest in accordance with paragraphs 3056.17-18 (i.e., reporting its share of assets, liabilities, revenue and expenses), the enterprise includes in its consolidated cash flow statement its share of the joint arrangement’s cash flows.

Non-cash transactions and contributions should be disclosed in a way to provide relevant information about these transactions.

NOTE: This is not an exhaustive list of reminders for all entities and types of investment, but it will assist in the identification of investments to assess which Sections may be applicable.

Document all conclusions. It is always important to document the analysis and reference sources to support the conclusion reached when exercising professional judgment.