AcSB Accounting Standards Board

Basis for Conclusions

Accounting for Related Party Financial Instruments and Significant Risk Disclosures

December 2018

CPA Canada Handbook – Accounting, Part II

Prepared by the staff of the Accounting Standards Board

Foreword

In December 2018, the Accounting Standards Board (AcSB) amended FINANCIAL INSTRUMENTS, Section 3856 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for the amendments.

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

December 2018

Table of Contents

INTRODUCTION

1 This document summarizes the AcSB's key considerations in reaching its conclusions in developing amendments to FINANCIAL INSTRUMENTS, Section 3856. This document sets out the reasons the Board undertook the project to develop this material, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual Board members gave some factors greater weight than other ones.

2 Nothing in this document overrides the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the Section and the Board's intent with respect to interpretation and application of the amendments.

BACKGROUND

3 In October 2014, the AcSB issued a Request for Information, "Post-Implementation Review: Section 3856, Financial Instruments." The post-implementation review provided the Board an opportunity to assess the standard's effects on financial statement users, preparers and practitioners, and considered whether:

(a) Section 3856 provides financial statement information that is decision-useful to users of the financial statements;

(b) there are unexpected costs or challenges in applying the requirements of the standard; and

(c) there are areas of the standard that present interpretation challenges and, as a result, affect its consistent application.

4 The AcSB received 12 comment letters and heard from 110 stakeholders at roundtables from across Canada. Overall, respondents to the post-implementation review supported the principles in the standard and most of its requirements. They also shared their feedback and made recommendations to the Board to help it improve the standard's usefulness and application. A summary of all the feedback received during the post-implementation review is available in the Feedback Statement the Board published in September 2015.

5 The AcSB used the following criteria when assessing the merit of adding a topic to its project plan:

(a) Is the issue pervasive or acute?

(b) How important is the matter to financial statements users?

(c) Is there a deficiency in the way a particular type of transaction or activity is reported in the financial statements?

(d) Are there alternative solutions?

(e) Is there other guidance available outside the standard?

(f) Would the cost of applying any new requirement exceed the benefit?

6 After applying these criteria and considering the Private Enterprise Advisory Committee's input, the AcSB decided that several topics, in addition to those included in this project, should be added to its work plan. The Board placed priority on the topics addressed in this project because:

(a) three of the most common issues raised by respondents to the post-implementation review were that:

(i) it is challenging to determine when Section 3856 and RELATED PARTY TRANSACTIONS, Section 3840 apply to the various elements of a related party transaction;

(ii) Section 3840 is challenging to apply to the initial measurement of financial instruments originated or acquired, issued or assumed in a related party transaction; and

(iii) financial instrument risk disclosures are not useful; and

(b) the other topics with merit would result in major projects and therefore should be considered in the context of the Board's relative priorities for Part II projects.

7 The additional topics that have merit but were not included in this project include:

(a) fair value measurement: to consider whether changes are required to address concerns raised about the relevance of using fair value to initially measure financial instruments, and the challenges with doing so;

(b) hedge accounting: to consider expanding the hedging relationships that qualify for use of hedge accounting;

(c) derecognition: to consider whether changes are required to the guidance related to the transfer of receivables and derecognition of financial liabilities; and

(d) classification of equity and financial liabilities: to consider whether additional guidance is needed to determine the classification of financial liabilities, such as non-redeemable limited partnership units, limited life entities and general partnership interests that do not participate significantly in the earnings of the enterprise.

The Board will consider how these additional topics should be prioritized, reflecting on the input it received from its July 2017 survey, AcSB Priorities for Part II, as well as input from its Private Enterprise Advisory Committee and other stakeholders.

8 During the development of the amendments, the AcSB consulted its Private Enterprise Advisory Committee and various other stakeholders, including practitioners and users.

9 The AcSB understands that some stakeholders raised various issues regarding Section 3840. The objective of these amendments is to address concerns on the accounting for financial instruments in a related party transaction. Stakeholders have recommended, and the Board agrees, that related party transactions should be one of its priorities. Accordingly, the Board has added related party transactions to its priorities for Part II.

10 In October 2017, the AcSB issued the Exposure Draft "Accounting for Related Party Financial Instruments and Significant Risk Disclosures." The Board received 10 comment letters and heard from 83 stakeholders at roundtables from across Canada. Respondents, including meeting participants, generally supported the Board's proposals. However, some respondents provided additional comments, suggesting changes to some of the proposals. The specific issues addressed in this project, including the substantive comments received on the Exposure Draft and any changes made in response to those comments, are discussed herein.

11 In September 2017, the AcSB issued the Exposure Draft "Retractable or Mandatorily Redeemable Shares issued in a Tax Planning Arrangement." The Board considered the two Exposure Drafts together when finalizing the amendments to Section 3856.

APPLICABILITY TO NOT-FOR-PROFIT ORGANIZATIONS

12 Not-for-profit organizations (NFPOs) apply the standards for private enterprises in Part II of the Handbook because the standards address topics not addressed in Part III. Therefore, NFPOs apply Section 3856 and, as a result, will be affected by these amendments. Accordingly, while developing the amendments, the Board consulted with its Not-for-Profit Advisory Committee to understand the circumstances that are unique to NFPOs when applying these amendments.

EFFECTS ANALYSIS

13 The AcSB acknowledges that the amendments will result in a change in practice for some preparers. The Private Enterprise Advisory Committee and the Not-for-Profit Advisory Committee advised the Board that there is diversity in practice in accounting for financial instruments in a related party transaction because the standards lack clarity or guidance. The Board thinks that the amendments will improve comparability in financial reporting for both the initial and subsequent accounting for financial instruments originated or acquired or issued or assumed in a related party transaction. Furthermore, the Board thinks that the amendments will reduce private enterprises' effort to understand and apply the guidance.

14 The AcSB acknowledges that there may be costs to some private enterprises and NFPOs to communicate to financial statement users the effect of the changes on the financial statements. However, the Board expects that the costs of the amendments would be minimal because the amendments would:

(a) not significantly change current practice for most preparers; and

(b) improve clarity by simplifying current requirements.

15 In accordance with FINANCIAL STATEMENT CONCEPTS, paragraph 1000.13, in developing accounting standards, the AcSB weighs the anticipated costs and benefits of its proposals in general terms to assess whether they are justified on cost/benefit grounds. The Board thinks that the amendments will improve the relevance, understandability and comparability of financial reporting.

DEVELOPMENT OF THE AMENDMENTS

16 Private enterprises account for related party transactions in accordance with Section 3840, which is built on the premise that related parties do not necessarily transact at fair value. Therefore, the AcSB decided that the principles underlying Section 3840 should be considered when developing these amendments. These amendments reflect the following:

(a) the presumption in paragraph 3840.10 that a transaction between related parties cannot be presumed to have been entered into at fair value;

(b) related parties may enter into transactions that unrelated parties would not; and

(c) related party transactions should not result in the recognition of gains or losses in net income, unless otherwise permitted by Section 3840.

Initial measurement of financial instruments in a related party transaction

17 The AcSB decided to include guidance on the accounting for financial assets originated or acquired and financial liabilities issued or assumed in a related party transaction, in Section 3856 to:

(a) clarify which standard applies, either Section 3840 or Section 3856, after the initial measurement of the financial instrument;

(b) address concerns expressed by stakeholders that the concepts in Section 3840 are difficult to apply to newly originated or issued financial instruments in a related party transaction; and

(c) provide guidance to NFPOs because:

(i) they are excluded from the scope of Section 3840;

(ii) there is not a measurement standard for related party transactions in Part III of the Handbook; and

(iii) the Board was advised by its Not-for-Profit Advisory Committee that there is diversity in practice among organizations regarding the initial measurement of financial instruments in a related party transaction.

18 The amendments will result in the following:

(a) Private enterprises will refer to Section 3856 for all aspects of accounting for financial instruments. Furthermore, private enterprises will continue to refer to Section 3840 to determine whether the parties in the transaction are related, for the initial measurement of the non-financial instrument element(s) exchanged in a related party transaction and for the disclosure of related party transactions.

(b) Similar to private enterprises, NFPOs will refer to Section 3856 for all aspects of accounting for financial instruments. NFPOs will refer to:

(i) DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4460 in Part III of the Handbook, to determine whether the parties in the transaction are related and for guidance on the disclosure of the related party transaction; and

(ii) CONTRIBUTIONS – REVENUE RECOGNITION, Section 4410 in Part III, to account for the extinguishment of financial liabilities exchanged in a related party, non-reciprocal transaction.

19 Most respondents agreed that the accounting for all financial instruments should be included in Section 3856. However, some respondents thought that only newly originated or issued financial instruments in a related party transaction should be included in the scope of Section 3856. Furthermore, these respondents thought that the accounting for the acquisition or assumption of financial instruments between related parties should remain in the scope of Section 3840. The AcSB considered this option when developing the Exposure Draft, but chose to include guidance for all financial instruments in Section 3856 to:

(a) have a single standard provide guidance on the accounting for financial instruments; and

(b) provide guidance to NFPOs on the accounting for all financial instruments exchanged in a related party transaction.

20 During the development of the Exposure Draft, the AcSB decided that the initial measurement of most financial instruments in a related party transaction should be consistent with the principles in Section 3840. Furthermore, the Board concluded that all financial instruments in a related party transaction, excluding derivative contracts and investments in equity instruments that are quoted in an active market, should be initially measured at cost.

21 When developing the Exposure Draft, the Board considered several options for the initial measurement of financial instruments in a related party transaction. The Board thought that initial measurement of financial instruments in a related party transaction at cost is preferable because:

(a) it does not require the determination of a market rate of interest for the financial instrument at initial recognition; and

(b) related parties do not necessarily transact at fair value; therefore, it would be inappropriate to require a financial instrument in a related party transaction to be initially measured at fair value.

22 The AcSB sought input from respondents to the Exposure Draft on whether other financial instruments in a related party transaction, in addition to derivative contracts and equity instruments that are quoted in an active market, should be initially measured at fair value. Some respondents thought that only those instruments in a related party transaction with available and reliable fair-value information should be permitted to be initially measured at fair value. In response to this feedback, the Board decided that debt instruments quoted in an active market and debt instruments with inputs significant to the determination of fair value that are observable should also be initially measured at fair value.

23 Cost is a concept that is deeply rooted in accounting standards for private enterprises; however, the Board was concerned that using the term “cost” to articulate the measurement of financial instruments is too broad and may lead to diversity in practice. Therefore, to provide further clarity, the Board included guidance for the determination of cost for financial instruments in a related party transaction.

24 During the development of the Exposure Draft, the AcSB decided that the cost of a financial instrument in a related party transaction will be influenced by whether the instrument has repayment terms. Therefore, the Board proposed that an enterprise determine whether a financial instrument in a related party transaction has repayment terms:

(a) If it does, the cost of the instrument is determined using the undiscounted cash flow(s) of the instrument, excluding interest and dividend payments of the instrument.

(b) If it does not (e.g., a common share), the cost of the instrument is determined using the consideration transferred by the enterprise in the transaction.

25 Most respondents to the Exposure Draft and members of the AcSB’s Private Enterprise Advisory Committee and Not-for-Profit Advisory Committee agreed with the Board’s proposals for the determination of cost, but highlighted the following concerns:

(a) Some financial instruments transferred in a related party transaction may have been previously impaired by the transferor. Therefore, it would not be appropriate for the acquirer to recognize these instruments at the undiscounted cash flow(s) of the instrument, excluding dividend and interest payments.

(b) NFPOs may be precluded from measuring a financial instrument in a related party transaction at the exchange amount of the consideration transferred because these transactions:

(i) often lack commercial substance; and

(ii) the change in ownership interests is often not substantive.

(c) It may be challenging to determine which standard an enterprise is applying when measuring the different elements of a related party transaction.

(d) It is unclear how the concept of undiscounted cash flows of the instrument, excluding interest and dividend payments, is applied to instruments with variable or contingent future payments.

26 In response to this feedback, the AcSB decided to:

(a) require that financial instruments transferred between related parties initially measured at cost be adjusted for any impairment losses previously recognized by the transferor;

(b) include criteria considering whether the transaction is in the normal course of operations as a condition for measuring a financial instrument using the exchange amount of the consideration transferred;

(c) develop a decision tree illustrating how the various elements to the related party transaction (both financial items and non-financial items) will be initially measured; and

(d) clarify that an enterprise is not required to measure the variable or contingent portion of a related party financial instrument until the contingency or variability is resolved.

27 The AcSB decided that related party transactions should not result in the recognition of gains or losses in net income unless otherwise permitted by Section 3840. Therefore, during the development of the Exposure Draft the Board decided that differences arising in related party transactions involving financial instruments should be included in net income if the transaction is measured at the exchange amount.

28 Some respondents and the AcSB's Private Enterprise Advisory Committee noted that the proposal was inconsistent with the various measurement methods that may be used in a related party transaction. The proposed amendments in the Exposure Draft, combined with the existing guidance in Section 3840 related to the initial measurement of non-financial elements in a related party transaction, may result in the elements of the transaction being measured at cost, fair value, carrying amount or exchange amount. Therefore, Advisory Committee members suggested that the accounting for differences arising in a related party transaction cannot be determined using the measurement of the transaction. Considering respondents and the Advisory Committee's input, the Board decided that:

(a) the accounting for differences arising from a related party transaction involving a financial instrument would be in the scope of Section 3856;

(b) the accounting for differences arising from a related party transaction involving a financial instrument will be recognized in net income when the transaction meets certain criteria; and

(c) the criteria used to determine the accounting for the difference arising from a related party transaction will be similar to the concepts in Section 3840 that are used to determine when a related party transaction is measured at carrying amount or exchange amount.

Subsequent measurement

29 The Private Enterprise Advisory Committee and respondents to the Exposure Draft informed the AcSB that the proposals resulted in inconsistencies between the initial measurement and subsequent measurement of financial instruments.

30 Therefore, to simplify the use of the standard, and to address the inconsistencies identified by respondents, the AcSB decided that the subsequent measurement of a financial instrument should align with the instrument's initial measurement.

31 If an instrument is initially measured at cost, it is subsequently measured using the cost method. The Board decided to subsequently measure these instruments using the cost method because it would result in the recognition of income from these investments only to the extent received or receivable.

32 The AcSB decided that the following two types of financial instruments will be subsequently measured using the cost method:

(a) equity instruments not quoted in an active market exchanged in a related party transaction; and

(b) debt instruments not quoted in an active market and for which inputs significant to the determination of fair value are not observable exchanged in a related party transaction.

33 If a financial instrument is initially measured at fair value, it is subsequently measured at cost, amortized cost or fair value.

34 The AcSB decided that equity instruments quoted in an active market and derivative contracts are required to be subsequently measured at fair value. The Board also decided that an enterprise may elect to subsequently measure the following financial instruments exchanged in a related party transaction at fair value:

(a) debt instruments quoted in an active market; and

(b) debt instruments, for which inputs significant to the determination of the fair value of the instrument are observable.

35 Furthermore, the amendments require an enterprise to discontinue measuring at fair value the following:

(a) an equity instrument of a related party when the instrument ceases to be quoted in an active market; or

(b) a debt instrument:

(i) originated or acquired in a related party transaction when the instrument ceases to be quoted in an active market and when inputs significant to the determination of fair value of the instrument are no longer observable; or

(ii) issued or assumed in a related party transaction when inputs significant to the determination of fair value of the instrument are no longer observable

Impairment of financial assets

36 During the development of the Exposure Draft, the AcSB decided that the indicators of impairment of a financial asset in paragraph 3856.A15 apply to all financial assets, and that the impairment should be recognized in net income. The Board also decided that the impairment assessment for related party financial assets would use the higher of the undiscounted cash flows expected to be generated by holding the asset, excluding the interest and dividend payments of the instrument and the amounts specified in paragraph 3856.17(b)-(c).

37 Many respondents agreed with the AcSB's proposals in its Exposure Draft. However, some Private Enterprise Advisory Committee members raised concern that the scope of paragraph 3856.17A should be expanded to include all financial assets originated or acquired in a related party transaction, consistent with the initial and subsequent measurement principles for these instruments. Considering respondent feedback, the Board decided to provide impairment guidance for all financial instruments originated or acquired in a related party transaction that are subsequently measured using the cost method and that the impairment of these instruments should be determined in accordance with paragraphs 3856.17A-.17B.

Forgiveness of related party financial assets

38 Respondents to the post-implementation review and the Private Enterprise Advisory Committee informed the AcSB that the accounting for the impairment of related party financial assets that are subsequently forgiven is unclear. They questioned whether both the impairment and subsequent forgiveness of a related party financial asset should be accounted for in net income or equity. They also noted that it is sometimes difficult to differentiate between the impairment and forgiveness of a related party financial asset.

39 During the development of the Exposure Draft, the AcSB decided that an enterprise should first assess for and recognize an impairment of a related party financial asset before recognizing any forgiveness of the financial asset. Financial statement users informed the Board that:

(a) acquirers commonly use net income and other income statement metrics (including earnings before interest, taxes, depreciation and amortization) to value acquisitions; and

(b) they classify the forgiveness of a related party financial asset based on the original nature of the transaction that gave rise to the financial asset, to avoid the overstatement or understatement of the income metric being used to value the acquisition.

40 Therefore, the AcSB decided that the forgiveness of the related party financial asset should be recognized in net income when the original transaction that gave rise to the financial asset was in the normal course of operations; and in equity when the original transaction was not in the normal course of operations. The Private Enterprise Advisory Committee informed the Board that, in practice, related party accounts receivable often includes a mixture of transactions (both normal and non-normal course), and that there may not be an objective way to identify the nature of the cash flows in this account. Therefore, the Board decided that the forgiveness of a related party financial asset should be recognized in net income when it is impracticable to determine whether the amount forgiven originated outside the normal course of operations. The Board also decided that if an enterprise recognizes the forgiveness in net income as the result of the enterprise applying paragraph 3856.19AA(b)(ii), it would disclose that fact and the nature of the transaction that gave rise to the financial asset forgiven.

41 Many respondents agreed that the classification of the forgiveness of a related party financial asset should be influenced by whether the original transaction that gave rise to the asset was in the normal course of operations. However, some respondents thought that while the original transaction may have been in the normal course of operations, the forgiveness decision itself may not have been. Therefore, they recommended that the forgiveness of all related party financial assets should be considered outside of the normal course of operations and recognized in equity (consistent with current Section 3840 guidance). The AcSB considered this feedback and concluded that financial statements would be most useful if the classification of the forgiveness of a related party financial asset is consistent with the original nature of the transaction that gave rise to the asset.

42 The AcSB sought input from Exposure Draft respondents as to whether NFPOs should be excluded from the scope of paragraph 3856.19AA, and if so, whether guidance is necessary on how NFPOs should account for the forgiveness of related party financial assets. Most respondents agreed that NFPOs should be excluded from the scope of paragraph 3856.19AA and that separate guidance for the accounting for these transactions by NFPOs is warranted. The Not-for-Profit Advisory Committee informed the Board that NFPOs normally account for the forgiveness of related party financial assets in the statement of operations. Consequently, the Board decided to issue separate guidance for NFPOs for the forgiveness of related party financial assets.

Liabilities and equity

43 The AcSB decided that an enterprise should be permitted to initially measure the equity component of a compound financial instrument issued between related parties as zero consistent with the acceptable methods used for the initial measurement of compound financial instruments issued in an arm's length transaction. In developing the Exposure Draft, the Private Enterprise Advisory Committee informed the Board that the equity component of compound financial instruments issued between related parties is often initially measured at a nominal amount ($1) or zero. Overall, respondents agreed with the proposal, as exposed.

Modification and extinguishment of financial liabilities in a related party transaction

44 The AcSB recognized when developing the Exposure Draft that:

(a) the guidance in paragraph 3856.A52(a) refers to the present value of future cash flows to determine whether the terms of a renegotiated financial liability differ substantially from the original financial liability;

(b) related party financial instruments are initially measured in accordance with Section 3840 and recognized at either carrying or exchange amount, without reference to the present value of future cash flows; and

(c) the Board's proposals in paragraph 3856.08 would initially measure these instruments at their undiscounted cash flows, excluding interest and dividend payments.

45 The Private Enterprise Advisory Committee informed the AcSB that:

(a) the most common renegotiation of related party financial liabilities includes changes to the interest rate of the instrument or its maturity date; and

(b) it is unlikely that the modification of a related party financial liability would result in an extinguishment, unless the enterprise forgives part of the financial liability.

46 The AcSB noted that the renegotiation of the discount rate or term of the financial liability would not change the undiscounted cash flows of the financial liability. Therefore, there would not be a difference between the carrying amount of the derecognized financial liability and the new financial liability. Therefore, the Board decided that all modifications of financial liabilities between related parties would be accounted for as an extinguishment of the original financial liability and recognition of a new financial liability and that any difference would be accounted for in accordance with paragraph 3856.28A.

47 Respondents agreed that the proposal would simplify the accounting for modifications of related party financial liabilities. However, some informed the AcSB that the guidance in paragraph 3856.A52 is challenging to apply to both related party and arm's length financial instruments. The Exposure Draft proposal clarified that the guidance in paragraph 3856.A52 would no longer be applicable for modifications of related party financial liabilities. The Board will consider in the context of its broader priorities whether a project related to paragraph 3856.A52 and the modification of financial liabilities between parties that transact at arm's length may be added to its project plan.

48 The AcSB also decided that for NFPOs, the resulting gain or loss on an extinguishment of a financial liability between related parties should be accounted for in accordance with Section 4410 of Part III of the Handbook. Accordingly, the Board excluded NFPOs from the scope of the proposals in paragraphs 3856.28A, 3856.42A and 3856.A58A. The Not-for-Profit Advisory Committee informed the Board that Section 4410 only applies to non-reciprocal transactions. Consequently, the Board clarified paragraph 3856.04A to include only financial liabilities exchanged in a related party transaction extinguished in non-reciprocal transactions.

Disclosure

49 Respondents to the post-implementation review expressed concerns that some financial instrument information disclosed in the notes to the financial statements, particularly the significant risk disclosure note, is not useful to users. Furthermore, respondents commented that financial instrument risk information disclosed in the notes to the financial statements is often boilerplate and not enterprise-specific. The Private Enterprise Advisory Committee informed the AcSB that:

(a) some of the information disclosed in the financial instrument risk note, including how a risk arose, is obvious based on the nature of the instrument and can be observed on the face of the financial statements; and

(b) preparers do not understand what “significant risk” means in paragraph 3856.53.

50 The AcSB is aware that there are multiple users of private enterprise and NFPO financial statements. Therefore, during the development of the Exposure Draft, the Board consulted different types of financial statement users regarding the usefulness of the risk disclosures in the financial statements. The Board asked users what information they found useful when making their resource allocation decisions. Overall, these users thought that financial instrument risk disclosure is useful when it is enterprise-specific and explains the enterprise’s current exposure to risk. Therefore, the Board decided not to remove the requirements to disclose how a significant financial instrument risk arose and encouraged preparers, in the Basis for Conclusions to the Exposure Draft, to make these disclosures enterprise-specific.

51 Some respondents to the Exposure Draft informed the AcSB that including guidance in the Basis for Conclusions may not lead to a change in practice because it is non-authoritative. Therefore, they encouraged the Board to include guidance in the standard that:

(a) requires an enterprise to disclose only relevant enterprise-specific information;

(b) clarifies when information is relevant; and

(c) clarifies that an enterprise discloses risks arising from financial instrument to which it is exposed at the end of the reporting period.

Consequently, the Board amended paragraph 3856.37 and added paragraph 3856.53A to provide guidance that clarifies the disclosure requirements and encourage enterprises to prepare their financial instrument disclosures using enterprise-specific information. An enterprise may have significant exposure to financial instrument risk, if for example, it has a significant amount of debt that is denominated in a foreign currency that is outstanding as at the end of reporting period. In this scenario, the enterprise should disclose information on the risk that the future cash flows of the debt instrument may fluctuate because of changes in foreign exchange rates. If, however the enterprise does not have significant exposure to foreign denominated financial instruments as at the end of the reporting period, it should not include foreign exchange risk information in its financial statements.

52 The AcSB was informed by financial statement users when developing the Exposure Draft that disclosure of financial instrument risk and uncertainty about derivatives is useful, but that this disclosure does not need to be provided separately from other financial instruments. After considering this input from users and the comments from respondents to the Exposure Draft, the Board decided that significant risks arising from derivatives should be provided, although it need not be done separately.

Transition

53 The AcSB noted that in the absence of specific transitional provisions, ACCOUNTING CHANGES, Section 1506, requires amendments to be applied retrospectively, except if it is impracticable. The Board thought that retrospective application would be useful since it would provide comparable information with the prior year. However, the Board recognized that some of the amendments may lead to changes in practice or be challenging to apply retrospectively and therefore decided to provide some relief when these amendments are applied for the first time.

54 The AcSB was concerned with the transitional implications of measuring a financial instrument, exchanged in a related party transaction, at cost when the instrument does not have repayment terms, and therefore needs to be measured using the consideration transferred by the enterprise in the transaction. An example of such an instrument would be a common share investment acquired in exchange for land. The Board decided that it would be impracticable to remeasure the common share investment in accordance with these proposals, particularly if the transaction happened several years ago. Therefore, the Board decided not to require remeasurement of a financial instrument that is measured using the consideration transferred by the enterprise, in accordance with paragraph 3856.08(b).

55 The AcSB also thought that it would not be useful to retrospectively apply the amendments to the financial instruments that do not exist on the date the amendments are first applied. Therefore, the Board decided that the amendments would only apply to those instruments that exist on transition.

56 The AcSB also noted a financial instrument that exists on the date the amendments are first applied may have been modified or a portion extinguished in the period preceding that date. In such situations, the amendments related to modifications and extinguishment of financial liabilities in a related party transaction will be applied as of the beginning of the earliest period presented.

EFFECTIVE DATE

57 The Exposure Draft proposed that the amendments would be effective for fiscal years beginning on or after January 1, 2020, because the AcSB thought that this would allow sufficient time for preparers to implement the proposed changes and to educate users on the proposals. The Board also decided that the effective date of these amendments will be the same as the amendments related to the Exposure Draft "Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement" and that preparers would be permitted to early adopt the amendments.

58 Most respondents to the Exposure Draft agreed with the proposed effective date. However, some respondents thought that the effective date for these amendments should coincide with the effective date of the "Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement" amendments and that if that project is delayed, the effective date of these amendments should also be delayed. Both Section 3856 projects have progressed without significant delay. Consequently, the AcSB decided that the effective date for both Section 3856 projects will be for fiscal years beginning on or after January 1, 2020.

CONSEQUENTIAL AMENDMENTS

59 The amendments will have an effect on other Sections. The rationale for some of the more significant amendments is described throughout the Basis.

EXPOSURE FOR COMMMENT

60 After resolving the issues arising from the exposure draft process, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.

61 The revisions have been highlighted in the relevant sections throughout the Basis. These revisions are clarifications based on feedback received from stakeholders. Other than clarifications already highlighted in the Basis, only minor drafting changes were made. Therefore, the AcSB decided that there was no need for re-exposure.