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THE CFO SERIES

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Classification of liabilities – Short Term vs Long Term

General Rules for Classification

1510.13 Non-current classification of debt is based on facts existing at the balance sheet date rather than on expectations regarding future refinancing or renegotiation. If the creditor has at that date, or will have **within one year** (or operating cycle, if longer) from that date, the **unilateral right to demand** immediate repayment of any portion or all of the debt under any provision of the debt agreement, the obligation is classified as a **current liability** unless:

a) the creditor has waived, in writing, or subsequently lost, the right to demand payment for more than one year (or operating cycle, if longer) from the balance sheet date;
b) the obligation has been refinanced on a long-term basis before the balance sheet is completed; or
c) the debtor has entered into a non-cancellable agreement to refinance the short-term obligation on a long-term basis before the balance sheet is completed and there is no impediment to the completion of the refinancing.

APPLICABLE TO ALL RENEWABLE DEBTS OR DEMAND LOANS

Presentation Option for a Callable Debt

Section 1510 proposes an interesting optional presentation for callable debt as follows:

ABC Ltd.
Balance Sheet (extract)

As at December 31 ($ thousands)	20X8	20X7
LIABILITIES		
Current:		
Accounts payable and accrued liabilities	$ 530	$ 613
Scheduled cash repayments for long-term debt (Note X)	410	410
Current liabilities before callable debt (Note X)	940	1,023
Callable debt (Note X)	440	330
Total current liabilities	1,380	1,353
Non-current:		
Long-term debt (Note X)	425	125
Total liabilities	$1,695	$1,478

Rules for Covenants Violations

1510.14 Long-term debt with a measurable covenant violation is classified as a current liability unless:

a) the creditor has **waived**, in writing, or subsequently lost, the right, arising from violation of the covenant at the balance sheet date, to demand repayment **for a period of more than one year from the balance sheet date**; or
b) the debt agreement contains a grace period during which the debtor may cure the violation and contractual arrangements have been made that ensure the violation will be cured within the **grace** period;
c) **and** a violation of the debt covenant giving the creditor the right to demand repayment at a future compliance date within one year of the balance sheet date **is not likely**.

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Related Party Financial Instruments

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Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures

HIGHLIGHTS OF THE AMENDMENTS

1. Reviewing the scope of Section 3856 to apply to all financial instruments.
2. Initial and subsequent measurement of related party financial instruments.
3. Guidance on impairment and forgiveness of related party financial instruments.
4. Significant risk disclosures requirements.

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Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.1 Revising the scope of section 3856 to apply to all financial statements

How should an entity account for a related party transaction which gives rise to a related party financial instrument? Should *Section 3840, Related party transactions* or *Section 3856, Financial instruments* apply?

Section 3840	Section 3856
Scope of Section 3840 applies to related party transactions involving **non-financial items**.	Scope of Section 3856 includes **all** financial instruments, regardless of whether they arise from an arm's length or a related party transaction.

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Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.2 Initial and subsequent measurement of related party financial instruments

Applying Section 3856

- Initial measurement: financial assets and financial liabilities are measured at **cost**, **except**:
  - Equity or debt instruments quoted in an active market.
  - Debt instruments, when inputs significant to the determination of fair value are observable.
  - Derivative contracts, when hedge accounting is not elected.
- Any variable or contingent portions are not initially recognized (but are disclosed).

Fair value

Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.2 Initial and subsequent measurement of related party financial instruments (cont'd)

What is cost?

With repayment terms	Cost is the undiscounted cash flows of the financial instrument: a) Excluding interests and dividends. b) Less any impairment losses previously recognized by the transferor.
If no repayment terms	Cost or exchange amount of consideration transferred.

Subsequently measured using the cost method.

Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.3 Impairment and forgiveness of related party financial instruments

Impairment

Arm's Length Financial Assets	Related Party Financial Assets
1. Indicators of impairment assessed annually. 2. Significant adverse change expected in timing or amount of future cash flows. 3. Write down **debt** to recoverable amount. Higher of: **a) Present value** of cash flows, discounted using a current market rate of interest. b) Amount realizable through sales. c) Amount realizable from collaterals.	1. Indicators of impairment assessed annually. 2. Significant adverse change expected in timing or amount of future cash flows. 3. i) Write-down **debt** to recoverable amount. Higher of: **a) Undiscounted** cash flows, excluding interests and dividends. b) Amount realizable through sales. c) Amount realizable from collaterals. ii) Write-down **equity** to amount realizable by selling the assets.

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Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.3 Impairment and forgiveness of related party financial instruments (cont'd)

Forgiveness

- **If impaired:**
  - Any write-down is charged to **P&L**.
- **If not impaired, but forgiven:**
  - Derecognition of related party financial asset is recognized in:

a) **Equity** when original transaction was NOT in the normal course of operations.
b) Otherwise recorded as an **expense**.

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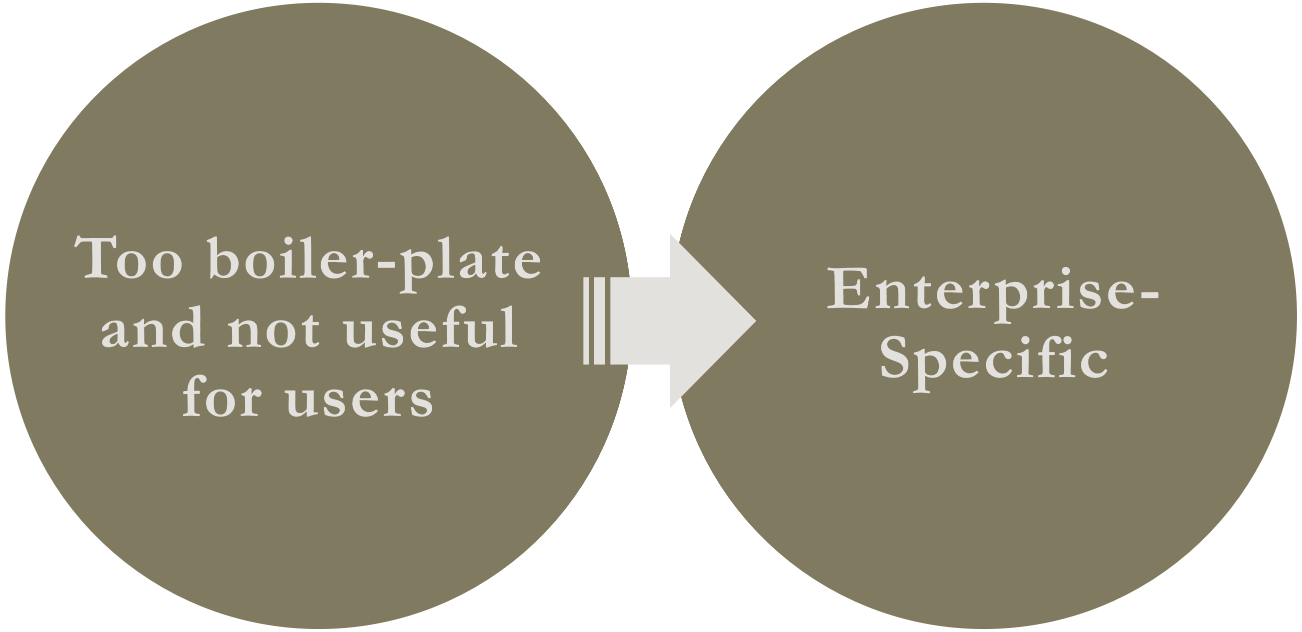
Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont’d)

1.2.4 Significant risk disclosures



Related Party Financial Instruments

1.2 Accounting for Related Party Financial Instruments and Significant Risk Disclosures (cont'd)

1.2.5 Effective date and transition

Effective Date

1. For fiscal years beginning on or after **January 1, 2021**.

2. Earlier application is permitted.

Transition

1. Apply **retrospectively**.

2. Transition relief:

    a) Applicable only to financial instruments **existing** at the transition date.

    b) For financial instruments **not existing at the transition date**, **need not to restate** the financial instruments as at the beginning of the earliest comparative period.

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Foreign Exchange

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Foreign Exchange

2.2 Subsequent Measurement of Foreign Currency Transactions

The accounting for a foreign currency transaction after initial recognition depends on whether the asset or liability is considered monetary or non-monetary.

Monetary Items: are money and claims to money the value of which (in terms of the monetary unit, whether foreign or domestic) is fixed by contract or otherwise. Future income tax liabilities and assets are classified as monetary items.

Non-Monetary Items: are assets and liabilities other than monetary ones.

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Foreign Exchange

2.3 Conversion of Foreign Operations

Recognition differs according to the type of foreign operation:

	Integrated	Self-Sustaining
Definition	Operation that is interdependent with the enterprise such that the exposure to exchange rate changes is similar to the exposure that would exist had the transactions and activities of the foreign operation been undertaken by the enterprise.	Foreign operation that is independent of the reporting enterprise such that the exposure to exchange rate changes is limited to the enterprise's net investment in the operation.
Translation Method	Temporal	Current method
Gains/Losses	Recognized on the income statement.	Recognized in equity under "translation adjustment."

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Foreign Exchange

2.2 Subsequent Measurement of Foreign Currency Transactions

Two Possible Methods:

	Temporal Method	Current Method
Retains Base of Measurement	In terms of CAN$ (uses CAN$ as unit of measure)	In terms of foreign currency (uses foreign currency as unit of measure)
Monetary Items	Closing market rate at BS date	Closing market rate at BS date
Non-monetary Items	Historical rate unless items are carried at market then closing market rate at BS date	
Revenue and Expenses	Rate in effect at date of the transaction	Rate in effect at the date of the transaction
Amortization	Historical rate of related asset	

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Foreign Exchange

4.2 Hierarchy for Determining Functional Currency

Determining Functional Currency

 OR  ?

- Functional currency is the currency of the primary economic environment in which an entity operates
  - Not a matter of free choice.
  - Assess each individual entity.
- Foreign currency is a currency other than an entity’s functional currency.
- Foreign operation is an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, whose activities are based or conducted in a country or currency other than that of the reporting entity.
- Presentation currency is the currency in which the financial statements are presented.

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Foreign Exchange

4.2 Hierarchy for Determining Functional Currency (cont'd)

- After analysis of primary indicators, is the functional currency apparent?
- If not, proceed to secondary indicators and additional factors.

Sales and cash inflows

Expense and cash outflows

Financing activities

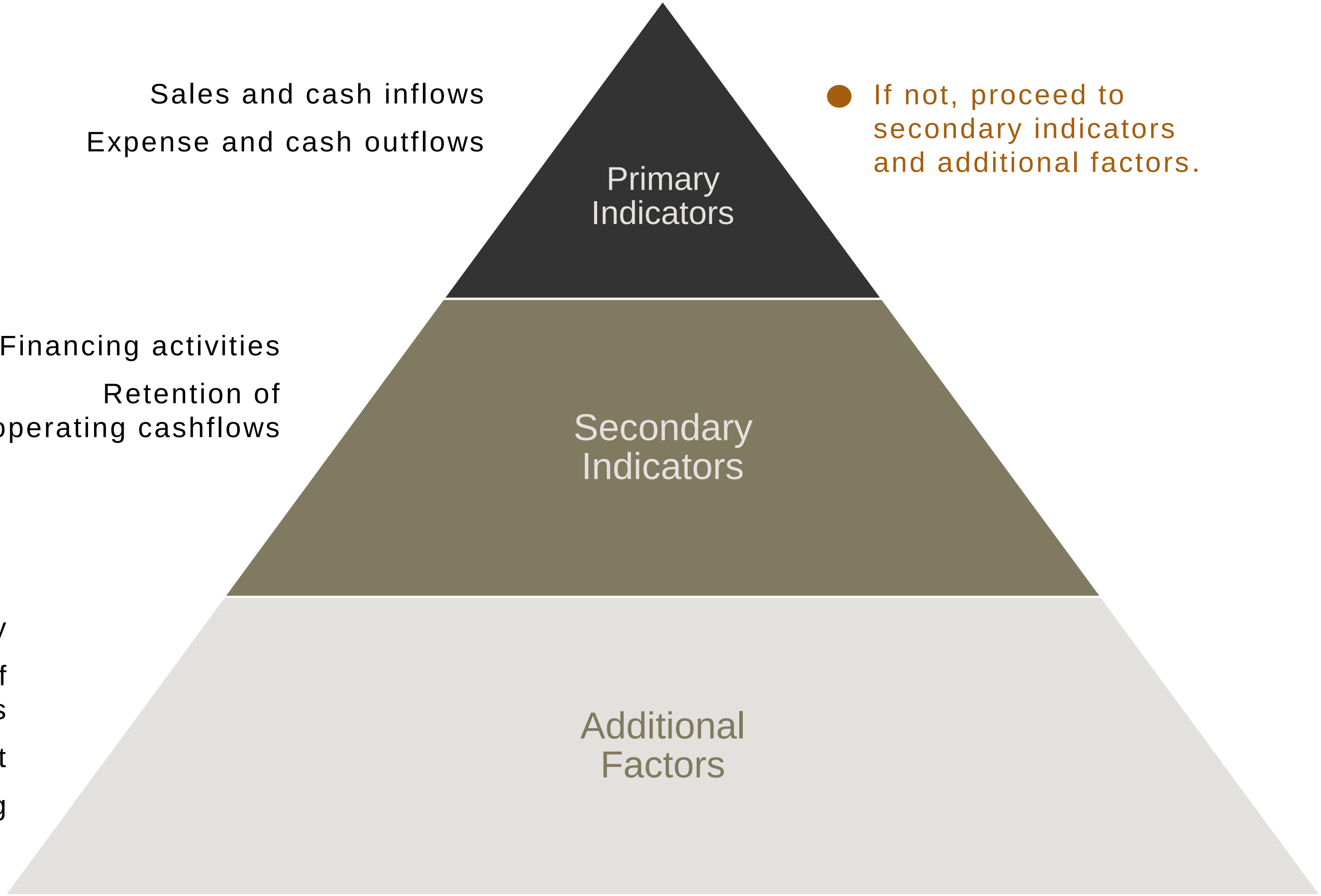
Retention of operating cashflows

Degree of autonomy

Frequency of inter-transactions

Cashflow impact

Financing



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Foreign Exchange

4.3 Translating into Functional Currency [1]

1. Initial Measurement

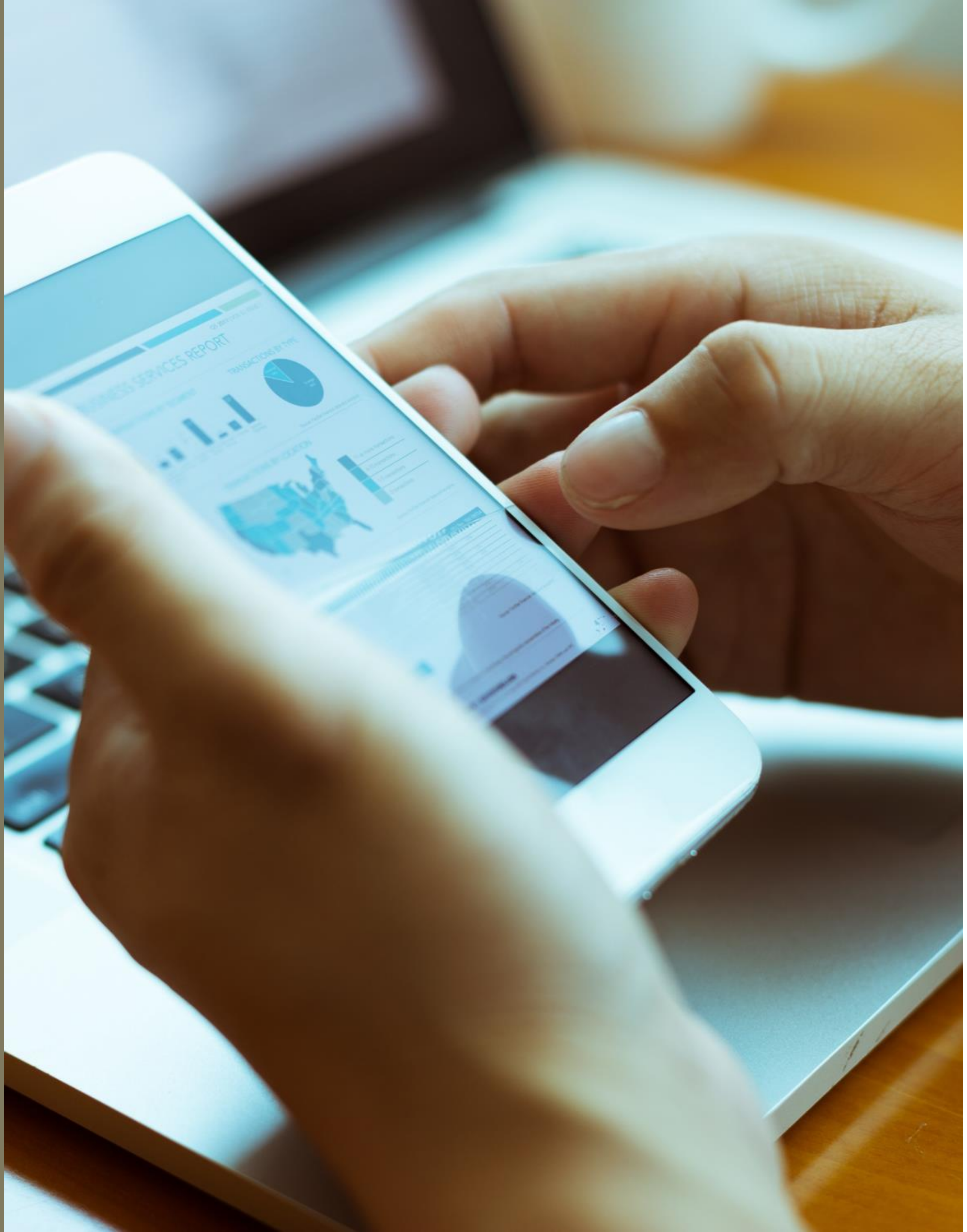
A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

2. Subsequent Reporting Period

At the end of each reporting period:

a) Foreign currency monetary items shall be translated using the closing rate;
b) Non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
c) Non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.

[1] For currency of non-hyperinflatory economy.



Foreign Exchange

4.4 Changes in Functional and Presentation Currency

- Changes in Functional Currency
  - A foreign entity that sells only parent-produced products assumes all manufacturing functions itself.
  - A foreign entity that sells its products only to its parent establishes
    a significant local sales market for those products.
  - The currency mix of the revenue for a given foreign entity changes.
  - An entity predominantly Canadian-based revenue changes to predominantly U.S.-based revenue due to the shift in targeted consumer groups.
- Prospective application.
- Comparative figures.

Foreign Exchange

4.4 Changes in Functional and Presentation Currency (cont'd)

Use of a Presentation Currency Other than the Functional Currency

- Matter of free choice.
- Foreign operation are translated for presentation purposes for inclusion into the reporting entity's financial statements by consolidation or the equity method.
- Translation

Assets and liabilities (including comparatives)	Income and expenses and other comprehensive income (including comparatives)	All resulting exchange differences are recognized in
↓	↓	↓
The closing rate	Rates in place at the dates when the transactions took place	Other comprehensive income 1)

1) In ASPE = CTA.

Foreign Exchange

4.4 Changes in Functional and Presentation Currency (cont'd)

Use of a Presentation Currency Other than the Functional Currency

Consider the options for a Canada company or group of companies that generates substantially all of its revenues and incurs considerable expenses in US dollars:

- **Functional** currency determined to be **U.S.** dollars. Presentation currency established as **Canadian** dollars.

  - **Avantage:** The primary users of the FS will be a Canadian shareholders and/or lenders who many require an equity pick up or where the credit facility agreement requires calculations of covenants in CAN dollars. FS presented in Canadian dollars would be more relevant for their financial reporting needs.

  - **Disadvantage:** Increased financial reporting and tracking as foreign exchange gains and losses will have to be presented as a component of other comprehensive income (OCI) with recognition of a cumulative translation adjustment (CTA).

- Establish the **functional** and **presentation** currency as **U.S.** dollars.

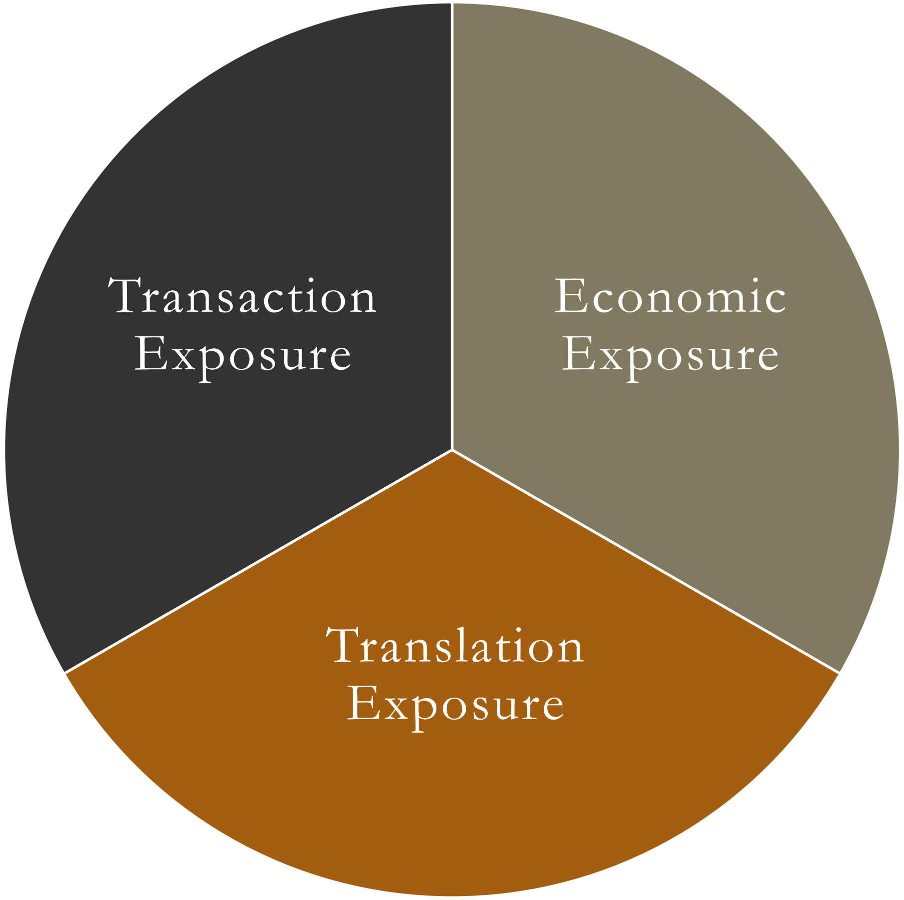
  - **Avantage:** Under this option, the financial statements will not be distorted by foreign exchange rate fluctuations rendering increase faithful representation.

  - **Disadvantage:** No additional financial accounting tracking and statement disclosure of other comprehensive income elements.

Foreign Exchange

2.5 Managing Foreign Exchange Risk

Foreign exchange risk can be classified into three key types of exposure:



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Foreign Exchange

2.5 Managing Foreign Exchange Risk (cont'd)

Strategies for Mitigating Foreign Exchange Risks

- Borrowing in foreign currencies.
- Monitoring and managing the repatriation of cash from foreign operations.
- Hedging the value of the net current assets in foreign operations and/or transactions with derivative and non-derivative financial instruments.
- Negotiating the contracts of foreign operations to be consistent with that of the parent organization.

CONCLUSION AND DISCUSSION

QUESTIONS AND COMMENTS

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THANK YOU!

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BUSINESS ADVISORY | FAMILY OFFICE SERVICES

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