KPMG Enterprise

Canadian Accounting Standards Update 2019

Tuesday, February 12, 2019

Newsletter - Business Matters

Today's presenters are…

Steve Woodward
Managing Director
Sector Lead, KPMG Enterprise

Felicia Wilsen
Director
Enterprise

Stephen Warren
Senior Manager
Enterprise

Jonnie Burnett
Manager
Enterprise

Tshepo Tshabalala
Manager
Enterprise

Shanay Brown
Manager
Enterprise

Mike Penrose
Senior Manager
Advisory

Sarah Robey
Senior Manager
Tax

New team members

Gareth Yeomans
Audit Senior
Enterprise

Shonette Harrison
Audit Senior
Enterprise

Nina Cadelina
Audit Senior
Enterprise

Joan Kamau
Audit Senior
Enterprise

Amu Mashale
Audit Senior
Enterprise

Jodian Williams
Audit Senior
Enterprise

Crystal Worrell
Audit Senior
Enterprise

KPMG Enterprise

Agenda

- Overview of current Canadian GAAP
- Accounting Standard for Private Enterprises (“ASPE”)
- Not-For-Profit Organisations
- Economic Substance Act
- IFRS Update
  - IFRS 9
  - IFRS 15
  - IFRS 16
- Public Sector Accounting Standards
- Trusts (Regulation of Trust Business) Act 2001
- Questions and answers

KPMG Enterprise

Overview of current Canadian GAAP

Agenda

CPA Canada Handbook – Accounting	Contents	Effective
Part I	International Financial Reporting Standards (IFRS)	January 1, 2011
Part II	Accounting Standards for Private Enterprises	January 1, 2011
Part III	Not-for-profit organizations	January 1, 2012
Part IV	Accounting standards for pension plans	January 1, 2011
CPA Canada Public Sector Accounting Handbook	Public Sector Accounting Standards – includes options for use of s.4200 series for government NFPOs	In effect – new sections PS 4200 effective January 1, 2012

KPMG Enterprise

Private and not-for-profit enterprises

Amendments, annual improvements and Exposure Drafts

Agenda

ASPE – changes effective in 2018 and beyond, annual improvements and exposure drafts:

- Narrow scope amendments to standards effective January 1, 2018;
  - Section 1591, Subsidiaries
  - Section 3051, Investments
  - Section 3056, Interest in Joint Arrangements

  2017 Annual improvements effective January 1, 2018;
  - Section 1505, Disclosure of Accounting Policies
  - Section 1506, Accounting Changes
  - Section 1521, Balance Sheet
  - Section 1651, Foreign currency Translation
  - Section 3065, Leases
- Amendments to standards effective January 1, 2020;
  - Section 3856, Financial Instruments (accounting for related party financial instruments and significant risk disclosures)
  - Sections 1591, 3251 and 3856 (Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement)

Section 1591, Subsidiaries

Section 3051, Investments

Section 1591, Subsidiaries ("1591")

Background

- New standard effective from January 1, 2016 to replace Section 1590, Subsidiaries and AcG-15, Consolidation of Variable Interest Entities.
- Amendments issued in 2016, effective January 1, 2018.
- Narrow scope amendments issued in 2016, effective January 1, 2018.

Overview of Section 1591

Scope Exemption	New Control Guidance	It's not IFRS 10	Recognition	Transition
1591 does not apply to accounting for contractual arrangements between enterprises under common control.	The definition of control has not changed. 1591 provides new guidance on accounting for subsidiaries controlled through rights other than equity interests.	1591 and IFRS 10 are not converged standards. For additional guidance, an entity can look to IFRS 10 through GAAP hierarchy.	There is an accounting policy choice to: • Consolidate; or • Prepare non-consolidated financial statements.	Transitional relief available.

Recognition Guidance

An enterprise makes an accounting policy choice to either:

- Consolidate; or
- Account for subsidiaries it controls through:

Voting interests, potential voting interests, or a combination thereof	Contractual arrangements	Voting interests in combination with contractual arrangements
• Using either cost or equity method	• In accordance with the applicable Section. For example a lease is measured in accordance with Section 3065.	• Voting interests in accordance with either the cost or equity method. • Contractual arrangements in accordance with applicable section.

Amendments - 1591 & 3051, Investments ("3051")

- Issued in December 2016 to address the accounting for a subsidiary and an investment subject to significant influence when the cost method is used.

Key aspects - 1591

- initial cost measured as fair value of the consideration transferred, including contingent consideration. Contingent consideration is re-measured when the contingency is resolved;
- acquisition-related costs are expensed as incurred;
- pre-existing relationships would be required to be separately identified and settlement of such relationships is considered a separate transaction;
- no recognition of bargain purchase gains (i.e., "negative goodwill");
- for a step acquisition, there is no re-measurement of previously held interest. Entities, however, are required to consider whether the cost of the additional interest acquired indicates an impairment; and
- where the initial accounting is incomplete at a reporting date, the carrying amount of the interest in the subsidiary is based on provisional amounts. Provisional amounts are adjusted in the period they are finalized, not retrospectively, with the measurement period not to exceed one year from the acquisition date.

KPMG Enterprise

Amendments – 1591 & 3051

Key aspects - 3051

- initial cost measured at the acquisition date as fair value of the consideration transferred;
- acquisition-related costs are expensed as incurred; and
- for acquisitions of additional interests there is no re-measurement of the previously-held interest. Entities are, however, required to consider whether the cost of the additional interest acquired indicates an impairment.

In September 2018 the AcSB issued an Exposure Draft that proposes to update Section 3051 to clarify that guidance relating to the cost method will also apply to interests in jointly controlled enterprises. Comments were due by December 5, 2018, with completion expected for Q2 2019.

KPMG Enterprise

Narrow Scope Amendments

- Transitional provisions under Section 1591 can only be applied on the initial application of the standard and may not be applied if an enterprise changes its accounting policy at any time after the initial application; and

- An enterprise preparing non-consolidated financial statements is not required to assess whether contractual arrangements give rise to control.

- Clarification on how the voting interest, if any, that an investor holds in a subsidiary controlled through a combination of voting rights and contractual arrangements should be accounted for when subsidiaries are not consolidated.

KPMG Enterprise

KPMG Enterprise

Section 3056, Interests in Joint Arrangements

Section 3056, Interests in Joint Arrangements ("3056")

Background

- New standard issued in March 2015 effective from January 1, 2016 to replace Section 3055, Interests in joint ventures.
- Under the new 3056, the policy choice to recognize investments in joint arrangements using the cost, equity, or proportionate consolidation methods has been removed. Instead, an investor must determine whether the economic activity represents a jointly controlled operation, jointly controlled asset, or jointly controlled enterprise.

Overview of Previously Issued New Guidance

Jointly Controlled Operations	Jointly Controlled Assets	Jointly Controlled Enterprises
Characteristic: use of assets and resources of the individual investors. **Accounting treatment** (i) recognize in the balance sheet, the assets that it controls and the liabilities that it incurs; and (ii) recognize in the income statement, its share of the revenue of the joint arrangement and its share of the expenses incurred by the joint arrangement.	**Characteristic:** involves the joint control, and often the joint ownership, of one or more assets contributed to, or acquired for the purpose of, the joint arrangement and dedicated to the purposes of the joint arrangement. **Accounting treatment** (i) recognize in the balance sheet, share of the jointly controlled assets and share of any liabilities incurred jointly with other investors in relation to the joint arrangement; and (ii) recognize in the income statement, any revenue from the sale or use of share of the output of the joint arrangement, and share of any expenses incurred by the joint arrangement.	**Characteristic:** involves the establishment of a corporation, partnership or other enterprise in which each investor has an interest. **Accounting treatment** (i) account for all such interests using the equity method; (ii) account for all such interests using the cost method; or (iii) recognize in accordance with the guidance described for transactions with jointly controlled operations or jointly controlled assets.

KPMG Enterprise

Narrow Scope Amendments

Clarification that the transitional provisions may not be applied when an enterprise changes its accounting policy choice at any time after initial application of Section 3056.

Transitional provisions

When transitioning from the equity or cost method to accounting for the investor's interests in the individual assets and liabilities of a joint arrangement, the investor may:

- apply full retrospective restatement;
- use the carrying amounts of the assets and liabilities in the financial statements of the joint arrangement at the beginning of the year immediately preceding adoption of Section 3056; or
- use the fair value of the tangible assets and liabilities of the joint arrangement at the same date.

KPMG Enterprise

KPMG Enterprise

2017 Annual Improvements to ASPE

Annual Improvements to ASPE

In July 2017, the AcSB finalised narrow scope amendments under the 2017 annual improvements to ASPE process. The following summarizes the amendments:

- **Section 1505, Disclosure of Accounting Policies** to be provided in 'one of the first notes' rather than 'as the first note', to the financial statements;
- **Section 1506, Accounting Changes** to remove the requirement to disclose the amount of an adjustment related to an accounting policy change for the current period and instead require disclosure of the amount of the adjustment required in the prior periods presented;
- **Section 1521, Balance Sheet** to clarify presentation and disclosure requirements, including that assets under capital leases should be presented separately on the face of the balance sheet or disclosed in the notes to the financial statements;
- **Section 1651, Foreign Currency Translation** to clarify the requirements on the reversal of previous write downs as a result of foreign currency translation of assets valued at the lower of cost and market;
- **Section 3065, Leases** clarifying that only the amount of the allowance for impairment, not the carrying amount of impaired operating lease receivables, is required to be disclosed.

The amendments are effective for years beginning on or after January 1, 2018. The AcSB intends that the amendments be applied retrospectively.

KPMG Enterprise

Section 3856 Financial Instruments

(accounting for related party financial instruments and significant risk disclosures)

Section 3856 Financial Instruments ("3856")

In December 2018 the AcSB issued final amendments to Section 3856, Financial Instruments, related to the accounting for financial instruments between related parties and significant risk disclosures.

- The scope of 3856 has been amended to make clear that the Section would apply to the initial and subsequent measurement, derecognition, presentation and disclosure of related party financial instruments.
- Guidance on how NFPOs initially measure related party financial instruments is added to 3856.
- An enterprise would apply the proposals retrospectively, in accordance with Accounting Changes, Section 1506, with simplified transitional provisions.

The amendments have an effective date of January 1, 2020.

New Guidance

Initial Measurement	Subsequent Measurement	Presentation of Impairment and Forgiveness	Modification and Extinguishment
Cost or FV if instrument is equity quoted in an active market or derivative contract. Election to measure financial assets or financial liabilities at FV prohibited. Cost transferred depends on whether the instrument has repayment terms.	Measure investments in equity instruments that are quoted in an active market and derivative contracts at fair value. Measure all other instruments at cost, less impairment*	Recognize impairment of related party financial asset in net income before the forgiveness is recognized. Recognize forgiveness in equity when original transaction was in normal course of operations, otherwise recognize in net income.	Account for all modifications of a related party financial liability as an extinguishment of the original financial liability and the recognition of a new financial liability.

*When a related party financial asset is impaired, reduce the carrying amount to the higher of:

- the undiscounted expected cash flows, excluding interest and dividend payments of the instrument;
- the amount that could be realized by selling the asset; and
- the amount the enterprise expects to realize by exercising its right to any collateral.

NFPO Guidance

- The amendments to Section 3856 include clarification that NFPOs will be required to recognize forgiveness of a related party financial asset in the statement of operations.

- NFPOs would recognize an extinguishment in accordance with Section 4410, Contributions – Revenue Recognition

Changes to Disclosure Requirements

- Requirement added to disclose when forgiveness or extinguishment recognized in net income because it was impracticable to determine whether the amount originated in the normal course of operations.

- Modifies the requirement to permit disclosures about significant risks arising from derivatives to be included with risks arising from other financial instruments, as opposed to requiring a separate disclosure.

KPMG Enterprise

Sections 159(1), 325(1) & 385(6)

Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement

•add guidance on recording in either retained earnings or a separate component of equity t
•add disclosure requirements for the shares.

Overview

In December 2018 the AcSB issued final amendments to Sections 1591, *Subsidiaries,* Section 3251, *Equity,* and Section 3856, *Financial Instruments*, related to the accounting for retractable or mandatorily redeemable shares issued in a tax planning arrangement.

- Section 1591 has been amended to add guidance on substantive rights to evaluate their effect on control assessments.

- Section 3251 has been amended to:
  - add guidance on recording in either retained earnings or a separate component of equity the effect of classifying the shares as a financial liability;
  - and add disclosure requirements for the shares.

- Section 3856 has been amended to revise the guidance on classification

The amendments have an effective date of January 1, 2020.

KPMG Enterprise

KPMG Enterprise

Section 3400 Revenue

Exposure Draft

•add guidance on recording in either retained earnings or a separate component of equity t
•add disclosure requirements for the shares.

Overview

The AcSB expects to issue an Exposure Draft in Q2 2019 to address issues about insufficient guidance on accounting for revenue in Section 3400, *Revenue*.

Guidance pertaining to the following topics was noted as being insufficient and leading to diversity in practice:

- bill-and-hold arrangements;
- multiple-element arrangements;
- percentage of completion method;
- reporting revenue gross or net; and
- upfront non-refundable fees/payments.

The project proposes to provide additional guidance on these topics.

KPMG Enterprise

Not-For-Profit Organizations

Accounting Standards Update - Part III of the CPA Canada Handbook

Summary

In March 2018, the Canadian Accounting Standards Board ("AcSB") issued the following standards in Part III of the CPA Canada Handbook – Accounting. The standards will be effective for annual periods beginning on or after January 1, 2019.

The following are the new standards:

- Section 4433, to replace Section 4431, *Tangible Capital Assets Held by Not-for-Profit Organizations*;
- Section 4434, to replace Section 4432, *Intangible Assets Held by Not-for-Profit Organizations*; and
- Section 4441, to replace Section 4440, *Collections Held by Not-for-Profit Organizations.*
- Transitional Provisions

All charities in the private sector that own tangible capital assets, intangible assets or collections may be affected.

Project in Process

- Contributions

Reminder

Changes to Part II (ASPE) will also impact NFPOs applying Part III.

KPMG Enterprise

Tangible capital assets - Overview

Main Changes

- Existing section 4431 Tangible Capital Assets is replaced by a new Section 4433. Overall there will be direction to apply accounting standards for private enterprises Part II of the Handbook (Section 3061), except where guidance is included in Section 4433.
- A primary effect of the new standards is an expected improvement in the comparability in financial reporting by removing duplicate guidance in Parts II and III for tangible capital assets and intangible assets in Part III.
- Section 3061 Property, Plant and Equipment would be used as the guidance to report:
  – the capitalization, amortization and disposal of tangible assets – largely similar with the current practice

Main Changes

– componentization for tangible capital assets – new concept for Not-For-Profit Organizations. This would entail, where practicable and when estimates can be made of the lives of the separate components, significant capital additions being accounted for on a component basis. For example, a building whereby different estimated amortization periods can be identified for the roof versus the bricks and mortar.

- Section 3110 Asset Retirement Obligations related to recognition, measurement and disclosure of liabilities related to long-lived assets and;

Main Changes

- Section 3063 Impairment of Long-Lived Assets for disclosure requirements related to impairment, including partial impairment, of long lived assets. Impairment adjustments will be to either fair value or replacement cost based on a list of indicators in section 4433 and 4434.

- NFPOs with revenues less than $500,000 are permitted to limit the application of Sections 4433 and 4434, the effects of the new standards would be minimal for smaller organizations.

KPMG Enterprise

KPMG Enterprise

Intangible capital assets - Overview

Main Changes

- The new section 4434 Intangible Assets will provide additional support and guidance related to intangible assets such as goodwill, trademarks and software.
- Reference is made to Section 3064 Goodwill and Intangible Assets, for the capitalization, amortization and disposal of such assets and Section 3063 Impairment of Long-Lived Assets, for impairment disclosures.
- Similar to tangible capital assets, the concept of partial impairment and write down decisions are supported by a list of indicators in section 4434 along with transitional guidance and disclosure requirements.

KPMG Enterprise

Collections - Overview

Main Changes

Collections can include a vast array of items such as paintings, writings, sculptures, artifacts, specimens, land and buildings.

Collection to be preserved in perpetuity and any proceeds from the sale of collection items must be used to acquire additional items or for the direct care of the remaining collection.

The existing Section 4440 *Collections Held by Not-For-Profit Organizations* is replaced with a new Section 4441. The amendments require that:

- Collections held be recorded on the Statement of Financial Position at either cost or a nominal value. Careful selection of cost or nominal value will be important as consistency in methodology will be required for all collections. Section 4440, was a disclosure standard and consequently did not address the recognition of collections.

Main Changes

- Consistent with the guidance included in Section 4433, Section 4441 would specify that when an item is purchased by an NFPO at substantially below fair value, the item would be recognized at its fair value, with the difference between the consideration paid and the fair value reported as a contribution.
- When collections are disposed of, the difference between the carrying value and proceeds will be accounted for in accordance with Section 4410 Contributions – Revenue Recognition, if externally restricted or through the Statement of Operations if not restricted. Losses made from the disposal of collections are recorded in the Statement of Operations

Main Changes

- Similar to Tangible Capital Assets, a partial or full write down will be required based on key indicators; the write down will be to fair value or replacement cost with the difference recorded as a charge to the Statement of Operations.
- Enhanced disclosure requirements will be included in the new section along with transition provisions.

KPMG Enterprise

Transitional Provisions

Transition Approaches

Overall transitional provisions are consistent with Section 1506 in Part II as follows:

- Prospective application for Sections 4433 and 4434 with relief for the allocated cost of tangible capital assets to their component categorization and an adjustment to opening net assets for partial impairments at the date of application of the new standard.
- Retroactive application for Section 4441 with relief for those deciding to record collections at cost.

KPMG Enterprise

Project in Process Contributions - Revenue Recognition

Latest update

The AcSB is performing additional research to better understand current practices of Not-For-Profit Organizations using the deferral method or restricted fund method.

This project includes:

Researching the recognition of revenue from contributions, as part of addressing the proposals that state;

- pledges should meet the definition of an asset in order to be recorded;
- a contribution stipulation should meet the definition of a liability in order to not be recognized as a revenue when received or receivable;
- when a stipulation gives rise to a liability, revenue would be recognized as the liability recorded is settled; and

Latest update

Addressing the implications of:

- eliminating the $500,000 size exemption in Part III that permits non-recognition of tangible and intangible capital assets; and
- applying the referenced standards in Part II to the presentation of financial statements subject to retaining guidance material in Part III that addresses unique financial statement presentation issues faced by not-for-profit organizations.

There have been no further developments in this project. On January 2019 the AcSB discussed a proposed project timeline and will continue the discussions at its May 2019 meeting.

KPMG Enterprise

Economic Substance Act 2018

February 12, 2019

Timeline

Nov 16 – The EU Code of Conduct Group “COCG” begins investigating the tax policies of non-EU countries against “good tax governance” standards, including tax transparency and fair taxation

Nov 17 – COCG receives a commitment from certain low-tax jurisdictions (“2.2 jurisdictions”) to introduce legal substance requirements to ensure that tax advantages are not granted to entities with no substantial economic presence

Dec 17 – EU list of non-cooperative tax jurisdictions was agreed by Member States

Jun 18 – COCG published a Scoping Paper for 2.2 jurisdictions

Dec 18 – 2018 ESA tabled and passed in the House of Assembly

Jan 19 – Adoption of the Economic Substance Act

Jan 19 – Release of Economic Substance Regulations 2018

ESA 2018 - Overview

Pursuant to the Economic Substance Act 2018 (“ESA”), an entity is required to meet the economic substance requirements in Bermuda to the extent it is engaged in any of the following “relevant activities”.

Leasing	Banking	Insurance	Fund management	Finance
Distribution & service centre	Intellectual property	Holding company	Headquarters	Shipping

Economic Substance Act ("ESA") cont.

Generally, the ESA applies to "registered entities" engaged in relevant activities, including:

Companies to which the Companies Act 1981 applies (including permit companies and overseas companies),

LLC

Limited liability companies formed under the Limited Liability Company Act 2016, or

Partnerships that have elected separate legal personality, including:

- exempted partnerships registered under the Exempted Partnerships Act 1992,
- exempted limited partnerships registered under the Exempted Partnerships Act 1992 and the Limited Partnership Act 1883
- overseas partnerships registered under the Overseas Partnerships Act 1995

The ESA is effective **January 2019**, with a 6-month transition period for entities in existence prior to such date. Pursuant to the ESA, the Minister has the authority to extend the transition period.

ESA is effective
January 2019

ESA 2018 - Substance Requirements

Pursuant to the ESA, an entity complies with the economic substance requirements if:

The entity is managed and directed in Bermuda

Core income generating activities (as defined in regulations) are undertaken in Bermuda with respect to the relevant activity

The entity maintains adequate physical presence in Bermuda

There are adequate full time employees in Bermuda with suitable qualifications

There is adequate operating expenditure incurred in Bermuda in relation to the relevant activity

ESA 2018 - Substance Requirements

The Regulations require an entity to provide information related to the economic substance requirements (and, in doing so, provide further guidance regarding such requirements), including:

The nature and extent of the relevant activity conducted, including the core income generating activities undertaken

The nature and extent of the entity's presence in Bermuda, including the physical offices or premises and an adequate level of operating expenditure in Bermuda

Whether the entity is managed and directed in Bermuda, having regard to:

- the location of strategic or risk management and operational decision making, or where management meets to make decisions regarding business activities
- presence of an adequate number of suitably qualified senior executives, employees or other persons in Bermuda responsible for oversight and/or execution of core income generating activities
- location of board meetings and the nature and frequency of the meetings held in Bermuda in relation to the overall number of meetings

Economic Substance Act ("ESA") cont.

The ESA requires entities to file an annual economic substance declaration with the Registrar. Specifics regarding the declaration, including the filing deadline, have yet to be released.

Civil penalties for failure to comply with ESA requirements range from **$7,500 - $250,000**. In addition, any person who knowingly provides false information to the Registrar shall be liable to a fine not exceeding $10,000 and/or to imprisonment for two years. In the event that such an offence is committed by an entity with the consent or connivance of another person (e.g. director), such other person shall be punished accordingly.

KPMG Enterprise

Relevant activities and core income generating activities

ESA 2018 - Focus

Headquarters

- Includes entities which engage in the general management and administration of its affiliates within or outside Bermuda
- The core income generating activities include taking relevant strategic or management decisions, incurring expenditures on behalf of affiliates, and coordinating group activities

ESA 2018 - Focus

Holding company

- A pure equity holding company only holds equity participations in one or more entities, and earns passive revenues from dividends, distributions, capital gains and other incidental income only

- Subject to **minimum** economic substance requirements
  - Has adequate employees for holding and managing equity participations, and adequate premises in Bermuda
  - Submission of an annual declaration form
  - Compliance with the corporate governance requirements of the Companies Act

KPMG Enterprise

ESA 2018 - Focus

Financing

- Includes entities which provide funds, other than by way of subscription for shares or other equity contributions, for the business activities of one or more other entities (whether or not affiliated)
- Core income generating activities include agreeing funding terms, setting the terms and duration of any financing, monitoring and revising agreements, and managing risk associated with such agreements

KPMG Enterprise

ESA 2018 - Focus

Shipping

- Includes entities which engage in ownership, leasing, operation or management of a ship that is used to transport goods.
- Core income generating activities include managing the crew (including hiring, paying and overseeing crew members), hauling and maintaining ships, overseeing and tracking deliveries, determining what goods to order and when to deliver them, and organizing and overseeing voyages.

KPMG Enterprise

How KPMG can help

How KPMG can help

- Many unanswered questions remain, and it is possible that the technical goalposts will continue to shift over time with:
  - the introduction of additional guidance,
  - the development of standards of “adequate” employees, premises, expenditure, and
  - commentary resulting from oversight activity by the Registrar and/or the EU/OECD.
- Despite these challenges, all entities will need to ensure compliance with the substance requirements of the ESA no later than July 1, 2019 (for existing entities)
- KPMG can assist entities in:
  - Completing an impact assessment of the ESA based on specific facts and circumstances
  - Assistance in assessing “adequate” levels of people, premises, and expenditure
  - Monitoring continuing developments in the legislation, regulations, and other guidance (in Bermuda and abroad), tracking industry standards of “adequate” and other relevant data (e.g. BEPS 5 activity)

KPMG Enterprise

What's next

Looking forward

- **Jan 19** – ESA effective for new Bermuda registered entities
- **Feb/Mar 19** – Final list of non-cooperative jurisdictions to be published by the EU
- **May 19**
- **Jul 1, 2019** – Transition period ends, all affected Bermuda entities expected to be compliant with economic substance requirements
- **Oct 18**
- **Nov 19**
- **Dec 31, 2019** – COCG expectation that additional legislation will be passed in 2.2 jurisdictions regarding beneficial ownership registries and additional information disclosure consistent with DAC6
- **2020 and later** – First economic substance declaration to be submitted to the Bermuda registrar
- **2020 and later** – AEOI between Bermuda Ministry of Finance and EU Member States regarding noncompliant entities and high risk IP

Other potential developments:

01 OECD substance requirements

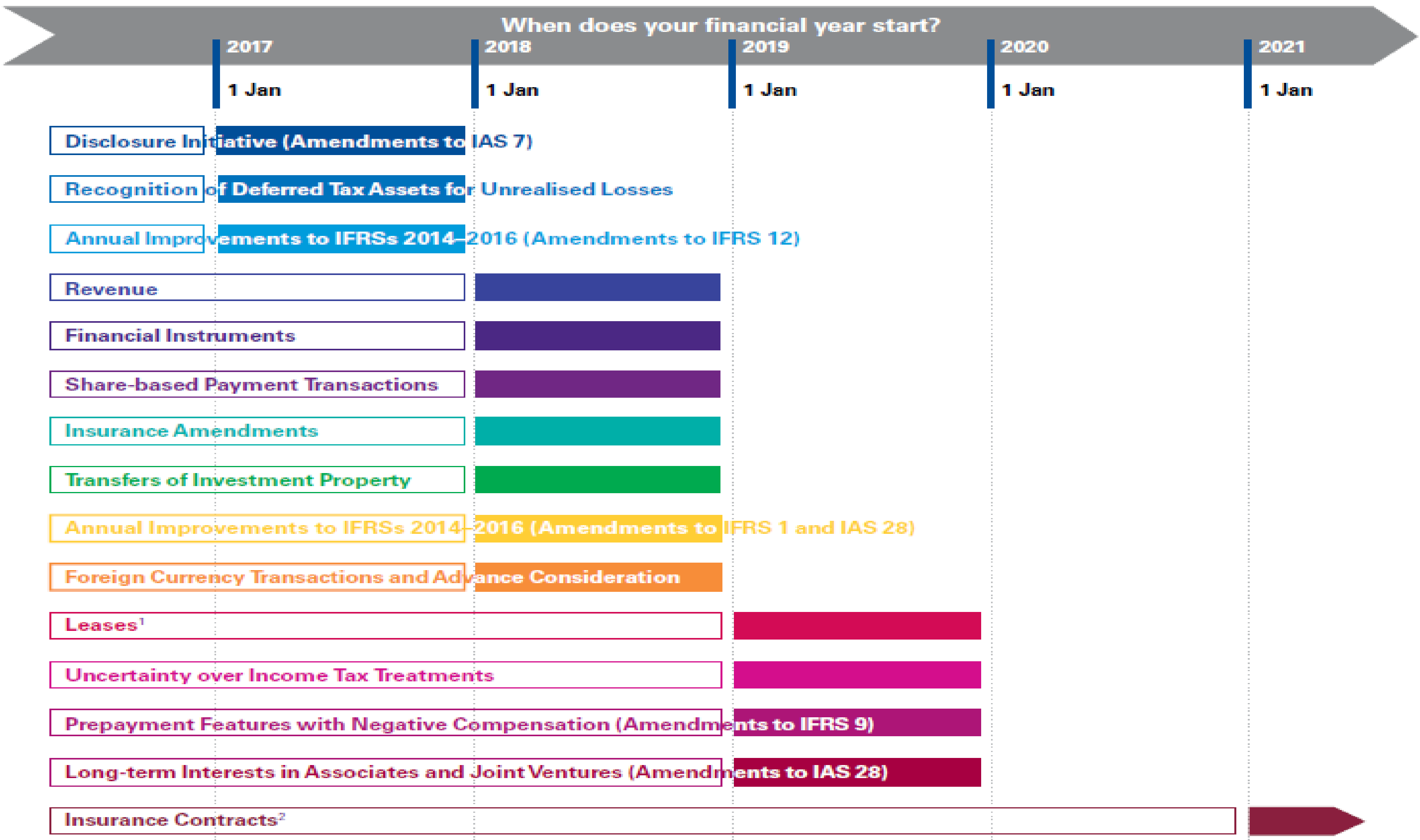
02 Issuance of additional economic substance guidance (Bermuda and elsewhere)

03 Ongoing review and oversight of economic substance regimes by the EU and/or OCED

IFRS: New Standards
Are you prepared?

Which standards are mandatory for my financial year end?

Which standards are mandatory for your financial year?



KPMG Enterprise

Key

Standards not yet effective, but available for early adoption.

Standards effective for the first time.

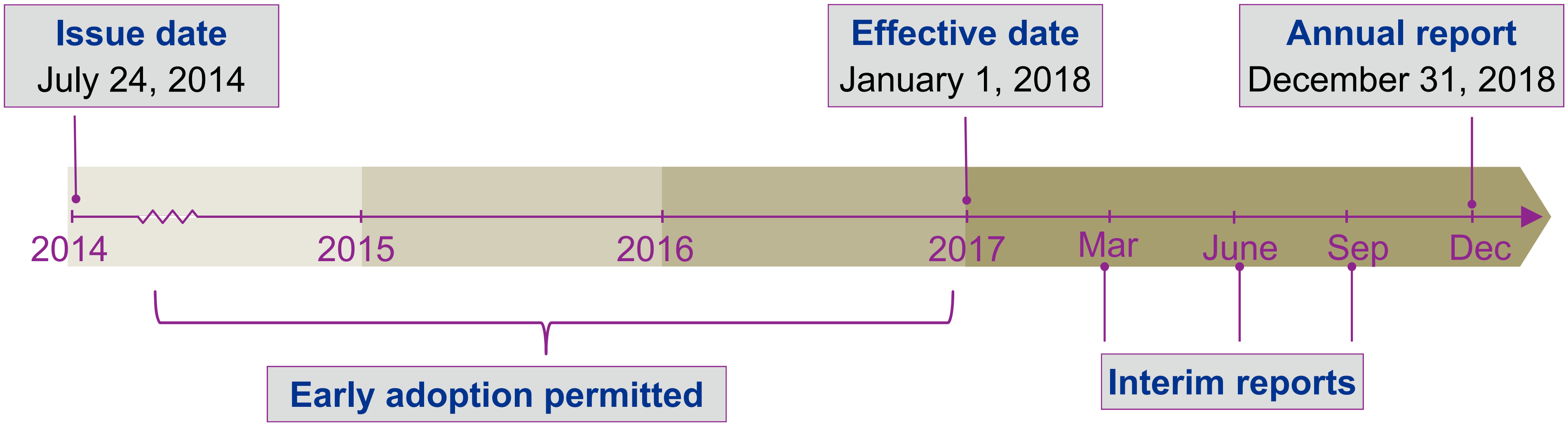
KPMG Enterprise

IFRS 9 Financial Instruments - Overview

Why is this important?

- The standard replaces IAS 39 and was introduced in 3 phases:
  - Phase 1 – classification & measurement
  - Phase 2 – Impairment
  - Phase 3 – Hedge accounting
- IFRS 9 will impact all entities, but especially banks, insurers and other financial companies.
- The impact will vary between industries and entities.
- Your stakeholders/investors will want to talk about the impact on your business.

Effective Date



Classification is the Key!

Classification determines:

- How financial assets are accounted for in the financial statements; and
- How they are measured on an ongoing basis.

One approach for all types of financial assets:

- **No bifurcation** of embedded features within financial assets.

Measurement of Financial Assets

All financial assets and liabilities are initially measured at fair value

Subsequent measurement

FV – through P&L

FV – through OCI

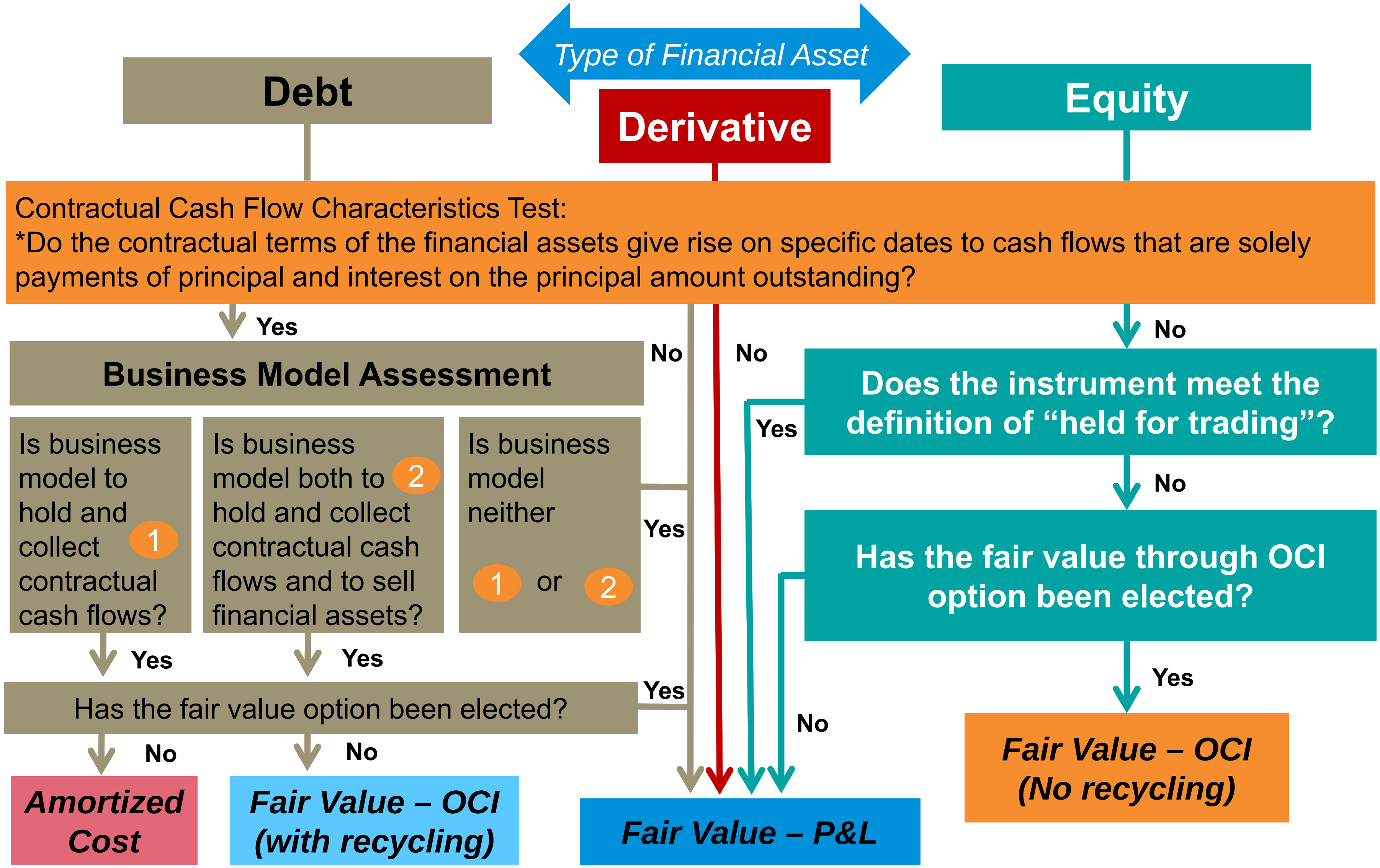
Amortized Cost

Classification based on

1. **Contractual cash flow characteristics of the financial assets**
2. **Entity's business model for managing the financial assets**

KPMG Enterprise

Classification Based on Type of Instruments



KPMG Enterprise

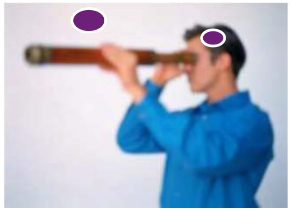
Measurement of Financial Liabilities

All financial liabilities are subsequently measured at amortized cost using the effective interest method except:

1. Financial liabilities that are held for trading
2. Financial liabilities designated as at FVTPL on initial recognition
3. Other financial liabilities, including:
   - Financial guarantee contracts
   - Commitments to provide loans at below market interest rates

From Incurred Loss Model to Expected Loss Model

What happened?



What will happen?

IAS 39: Incurred Loss Model:

1

Asses whether there is "objective evidence that impairment exists"

- Should be done at least at each reporting date
- Based on available information at reporting date
- If there is no objective evidence of impairment, no further action is needed

2

Calculate amount and recognize impairment loss

- Interest bearing – write down to recoverable amount based on discounted cash flows
- Non-Interest bearing – write down to recoverable amount base on fair value

IFRS 9: Expected Loss Model:

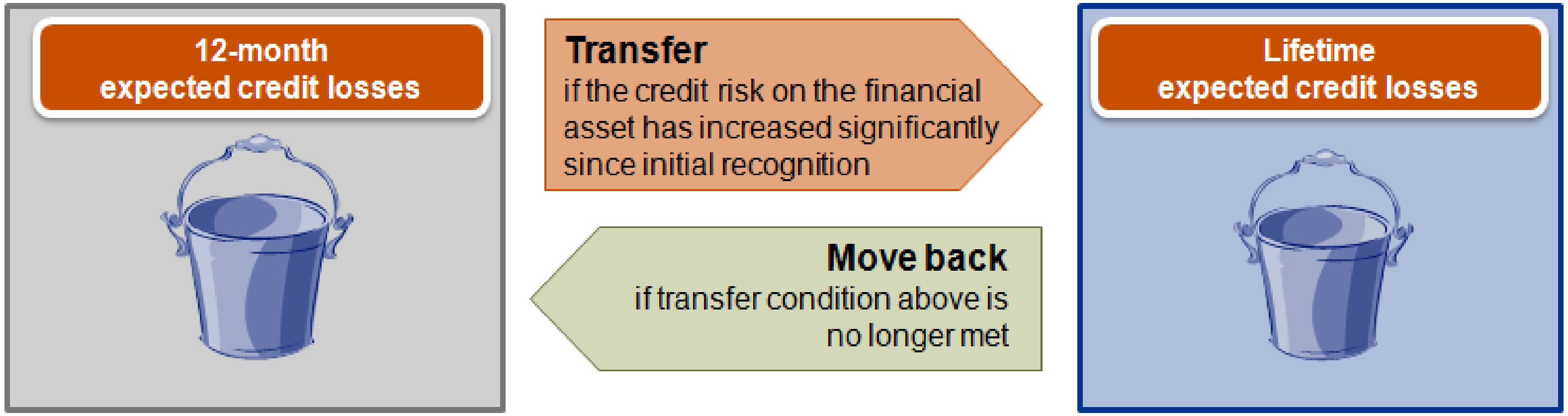
1

Credit losses to be measured as the 12-month expected credit losses, based on probability-weighted outcome, the time value of money and the best available information.

2

If credit risk increases significantly after initial recognition, credit losses to be measured as the lifetime expected credit losses.

Dual Measurement Approach



- **Under the general principle, one of two measurement bases will apply:**
  - 12-month expected credit losses; or
  - lifetime expected credit losses.
- **The measurement basis would depend on whether there has been a significant increase in credit risk since initial recognition.**

Trade and Lease Receivables and Contract Assets

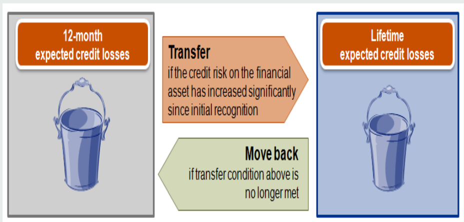
Lease receivables

Trade receivables and contract assets **with a significant financing component**

Trade receivables and contract assets **without a significant financing component**

Policy election to apply

General approach



Simplified approach

Loss allowance **always** equal to lifetime expected credit losses.

Practical expedient to calculate expected credit losses – provision matrix.

Loss Allowance Recognition: Illustration

- On 31 December 20X1 Bank B grants a loan to a borrower with low credit standing, but still at an acceptable level for B.

Q: What loss allowance should B recognise in the statement of financial position at 31 December 20X1?

A. None.
B. 12-month expected credit losses.
C. Lifetime expected credit losses.

Loss Allowance Recognition: Rationale

B. 12-month expected credit losses.

- Under the general model of IFRS 9, all assets need to have a loss allowance.
- Allowance covers either 12-month or lifetime expected credit losses **depending on whether the asset's credit risk has increased significantly.**
- Since the loan has just been granted and there has not been a significant increase in credit risk, an allowance equal to 12-month expected credit losses is appropriate.

Assessment of Significant Increase in Credit Risk: Illustration

- Bank B uses an internal credit grading system of 1 to 10.
- A **drop of 2 grades represents a significant increase in credit risk.**
- Bank B has two loans:
  - Loan 1: Graded 2 at initial recognition, Graded 4 at the reporting date.
  - Loan 2: Graded 3 at initial recognition, Graded 4 at the reporting date.

Q: At the reporting date, would each loan attract a 12-month or lifetime expected credit loss allowance?

KPMG Enterprise

Assessment of Significant Increase in Credit Risk: Rationale

Loan 1: Loss allowance = lifetime expected credit losses

Loan 2: Loss allowance = 12-month expected credit losses

- **The credit loss model in IFRS 9 is a relative rather than an absolute model which means that it focuses on the relative size of increase in credit risk.**

Class Discussion: Trade Receivables

- **Dove Corp. manufactures and sells products to a broad range of customers through its retail stores.**
- **Customers typically are provided with payment terms of 90 days with a 2% discount if payments are received within 60 days.**
- **Dove has tracked historical loss information and compiled historical credit loss percentages for its entire trade receivable portfolio.**
- **None of the receivables includes a significant financing component.**

Are historical loss percentages appropriate and a reasonable base on which to determine expected credit losses?

Class Discussion: Trade Receivables

Dove has tracked historical loss information and compiled the following historical credit loss percentages:

Past-due Status	Historical Loss Rate
Current	0.3%
1-30 days past due	8%
31-60 days past due	26%
61-90 days past due	58%
>90 days past due	82%

Are trade receivables that are "current" required to be considered in the ECL calculation?

What other considerations must be given to determine allowance under ECL?

Key Points to Remember!

- **IFRS 9 will impact entities in different ways:**
  - Banks, insurers and other financial sector entities are likely to be significantly impacted.
  - Impact on other corporates may be less.
- **IFRS 9 introduces extensive new disclosure requirements.**
- **This overview covers IFRS 9 at a very high level – in reality there are many detailed and complex requirements.**

KPMG Enterprise

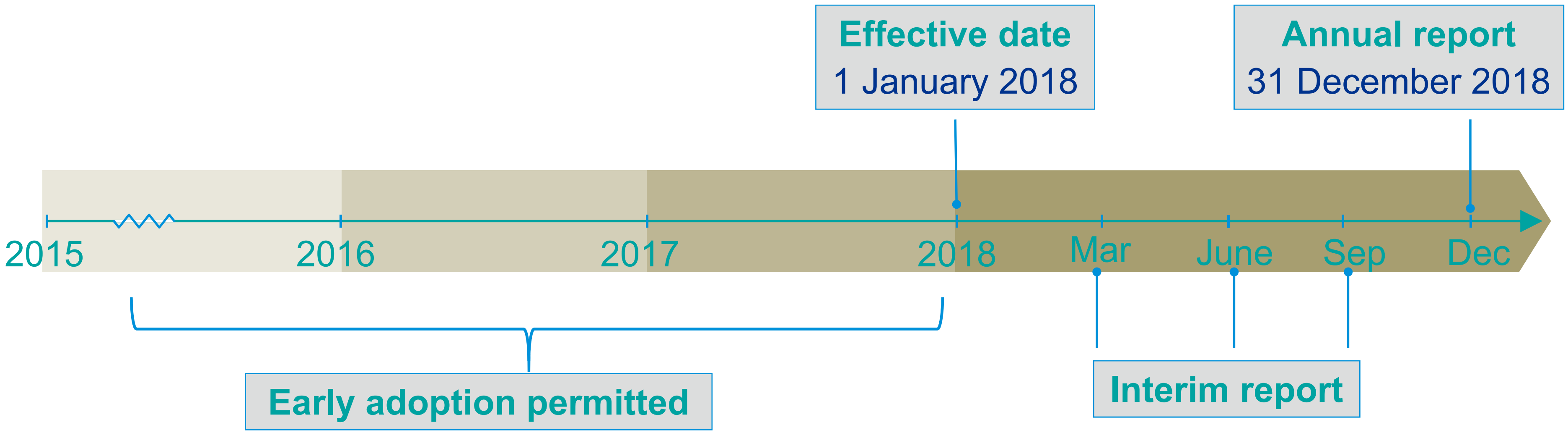
IFRS 15 - Revenue from contracts with customers

IFRS 15 - objective and effective date

- Standard issued by IASB in May 2014 replaces current revenue guidance contained in IAS 18 and 11
- Principle based requiring judgment in its application
- New criteria for when revenue is recognized – when customer has control of good and services

"The core principle of IFRS 15 is that an entity recognizes revenue in an amount that the **entity expects to be entitled to** in exchange for goods or services as **control** passes to the customer."

Key Facts - Effective Date



The Five Step Model Overview

1. Identify the contract with a customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue

Identify the Contract

STEP

1

A contract exists if...

... consideration is **probable**

... goods or services and payment terms can be **identified**

... has **commercial substance**

... parties are **committed** to their obligations

Key Changes From Current Guidance

STEP
2

2 Identify the performance obligations

Performance obligation → promise to deliver a good or service that is **distinct**.

Distinct if **both** criteria below are met

Individually
Customer can benefit from use **on its own**

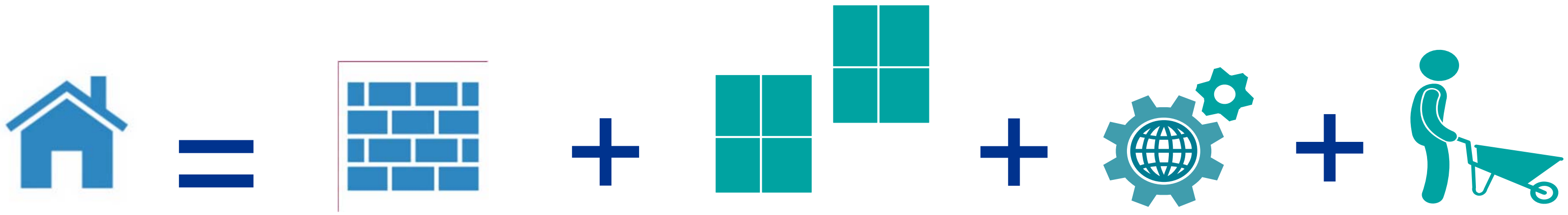
+

Context of contract Separately identifiable

NOT highly dependant on other promises in the contract

Single performance obligation?

STEP
2



Contract to build a house = Bricks + Windows + Fittings + Construction service

Do the goods and services individually meet the 'performance obligation' criteria?

Criterion 1 – Benefit on its own or with other resources

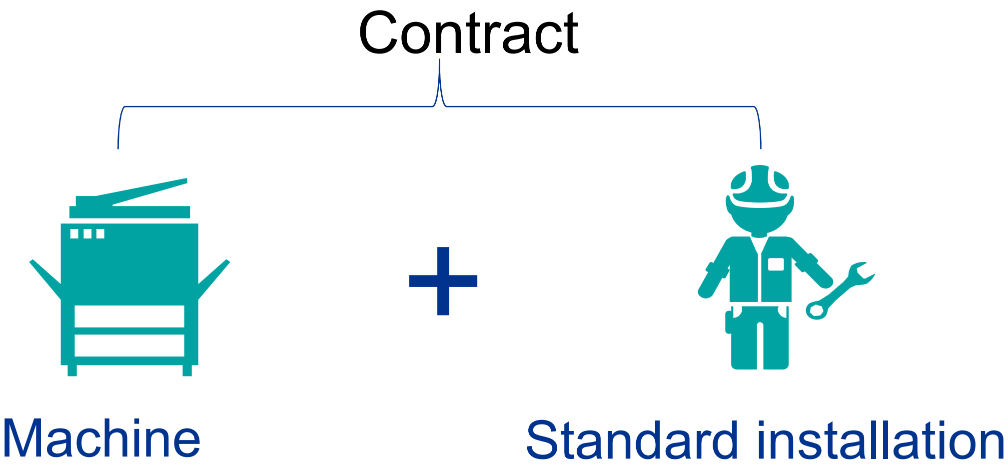
Each material could be used with another readily available item.

Criterion 2 – Good or service is separately identifiable

Entity is providing a significant integration service.

Multiple performance obligations

STEP
2



Installation services are also offered by third party providers.

Does the machine and the installation service meet the 'performance obligation' criteria?

Criterion 1 – Benefit on its own or with other resources ✓

Machine and installation can be used with other available resources.

Criterion 2 – Good or service separately identifiable ✓

No significant integration service, installation is a standard service and installation and machine are not highly inter-related.

Key Changes From Current Guidance

STEP
3

3 Determine the transaction price

Consideration → amount entity **expects** to be **entitled** to

Variable consideration

Significant finance component

Fair value measurement ✗

Key Changes From Current Guidance

STEP
4

4

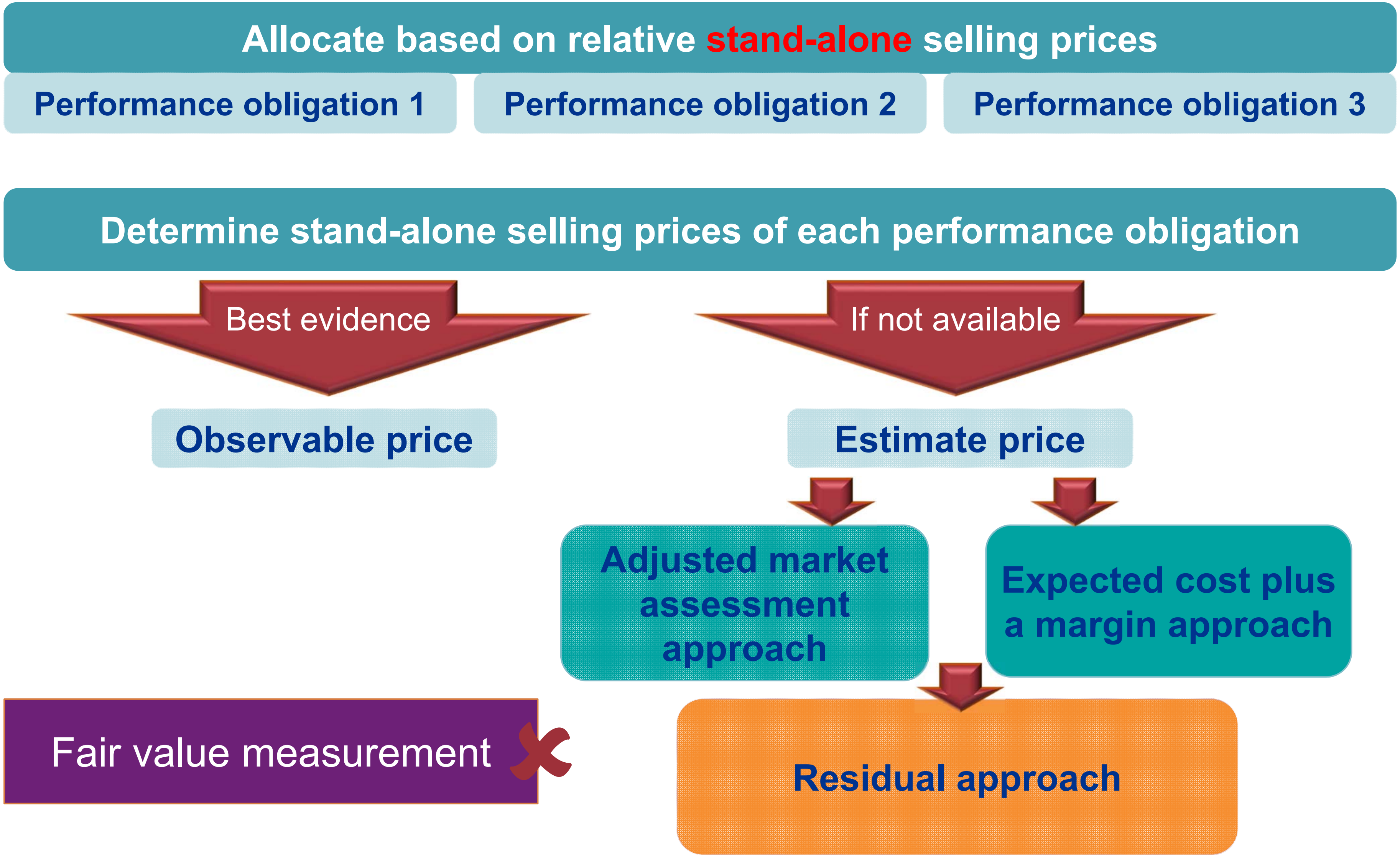
Allocating the transaction price

Allocate revenue based on relative **stand alone selling price** of goods/service.

Allocation should depict the amount the entity **expects to be entitled to for each performance obligation**

Allocate the Transaction Price to Performance Obligations

STEP
4



Step 5: Key Changes From Current Guidance

STEP
5

5

Recognize revenue

Control based model

Over time		Point in time
If performance obligation criteria met	or	If performance obligation criteria not met

Risk & rewards based model ✗

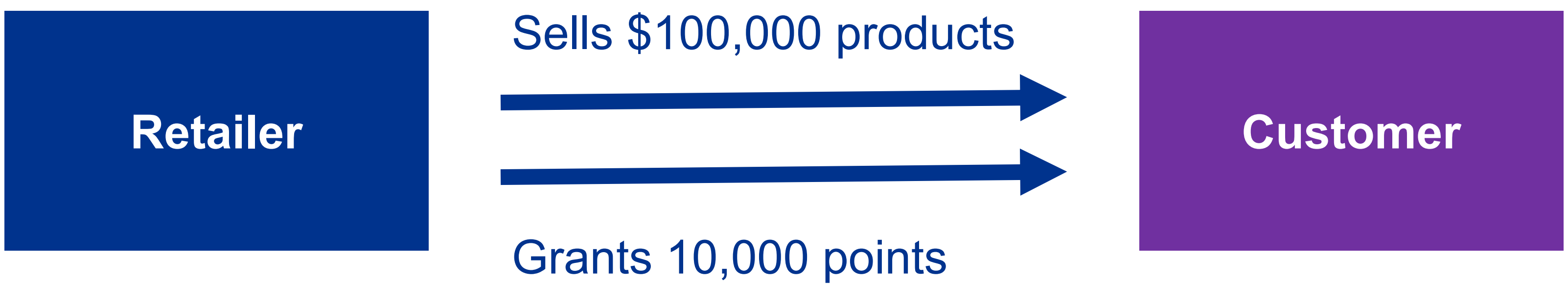
Example - Customer loyalty program

Retailer offers a customer loyalty program.

For every $10 that customer spends, they are rewarded with one point.

Retailer expects 97% of points to be redeemed.

During Year 1, customers purchase products for $100,000 and earn 10,000 points.



The program provides the customers with a material right, because the customers would not receive the future discount without making the original purchase. **The sale therefore creates 2 separate performance obligations.**

Solution - Customer loyalty program

Background

– During Year 1, customer purchases products for $100,000 and earns 10,000 points.

– **STEP 1 : Calculate the selling price ratio**

Performance obligation	Stand-alone selling prices	Selling price ratio
Products	100,000	91%
Points	9,700 a)	9%
	109,700	100%

a) **10,000 points x97%**

What amount of transaction price should be allocated to the points?

Solution (continued) - Customer loyalty program

Decisions, considerations and guidance and referenced

- **STEP 2 – allocate revenue to be recognized based on the selling price ratio**

- Retailer recognizes a **contract liability** in the amount of **$9,000 {$100,000 * 9%)**

Performance obligation	Stand-alone selling prices (A)	Selling price ratio (B)	Price allocation (AxB)
Products	100,000	91%	$91,000
Points	9,700	9%	**9,000**
	109,700	100%	$100,000

Example - Sales with a right of return

Background

- Company B sells **50 tablet devices @ $200 each** to a customer, for a total of **$10,000.**
- Customer can return undamaged devices within **30 days** for a full cash refund.
- **Cost of each device is $150.**
- Based on its past experience, B estimates that 3 tablets will be returned (most likely approach).

What amount does B recognize as revenue?

Warranties

- Two types

  1) Assurance

  2) Service

- What distinguishes them is whether the warranty simply provides assurance that the product complies with agreed-upon specifications or whether it provides an additional service to the assurance

- Option to purchase a warranty - service-type warranty - separate performance obligation

- No additional service provided - assurance-type warranty - IAS 37

Key points to remember

– The revenue recognition model includes five steps.

– The best way to apply the model is to apply the model step by step.

– A contract may include one or more separate performance obligations.

– The transaction price is allocated to identified performance obligations using stand alone selling prices.

– The allocation is recognised as revenue either over time or at a point in time.

KPMG Enterprise

IFRS 16 Leases

A more transparent balance sheet

More transparent lease accounting

"IFRS 16 will bring most leases on-balance sheet from 2019. All companies that lease assets for use in their business will see an increase in reported assets and liabilities.

This will affect a wide variety of sectors, from airlines that lease aircraft to retailers that lease stores. The larger the lease portfolio, the greater the impact on key reporting metrics."

Kimber Bascom,

KPMG's global IFRS leasing standards leader

What's the issue

Currently analysts adjust financial statements for off- balance sheet leases

Under IFRS 16, companies will bring these leases on balance sheet, using a common methodology

KPMG Enterprise

Major impacts for lessees

Lessees face major changes

All major leases on balance sheet

Balance sheet

Asset

= 'Right-of-use' of underlying asset

Liability

= Obligation to make lease payments

P&L

Lease expense

Depreciation

+ Interest

= Front-loaded total lease expense

KPMG Enterprise

New definition, new accounting

Lease definition

The new on/off-balance sheet test for lessees – a key judgement area

	Lease classification test	ON	OFF
New standard	✗	Lease	Service
Old standard	✓	Finance lease	Operating lease

Lease definition - control

The new definition increases focus on who controls the asset and may change which contracts are leases

Lease

Not a lease ?

Lease definition - Exemptions

Two major optional exemptions make the standard easier to apply

Short term leases

≤ 12 months

Leases of low value items

≤ USD 5,000 for example

KPMG Enterprise

Measuring the lease liability

Lease liability = **Present value of lease rentals** + **Present value of expected payments at end of lease**

Lessor accounting

Lessor accounting remains similar to current practice…

but lacks consistency with new lessee accounting model

- Lease classification test ✓
- Finance leases and operating leases ✓
- Consistent accounting model for lessors and lessees ✗

KPMG Enterprise

Multiple transition options

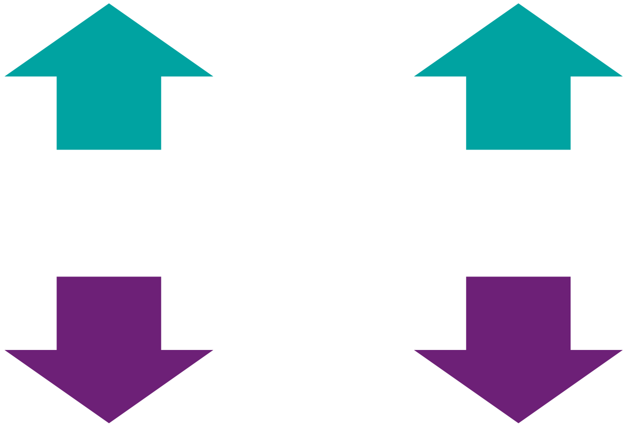
Applying the new lease definition

Cost **Comparability**

Apply the new definition to all contracts

OR

Grandfather existing contracts and apply the new definition only to new contracts



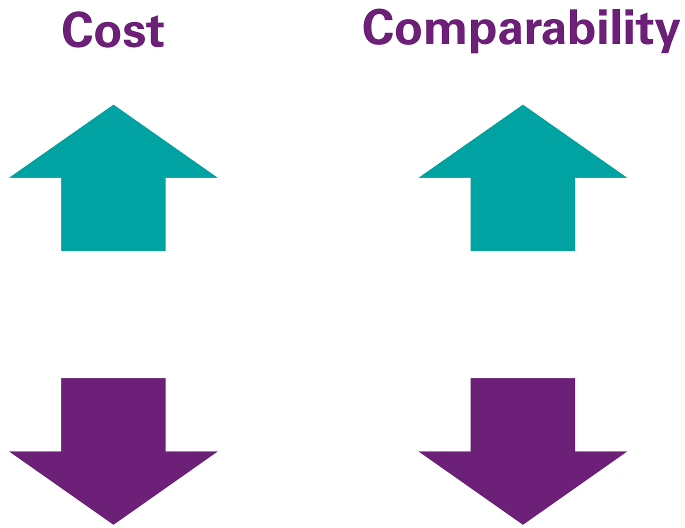
Applying the new standard

A lessee can choose to apply the standard…

Retrospectively to all accounting periods

OR

As a 'big bang' at the date of initial application



Next steps

Things to think about now

Some questions to assess the impact on your company's financial statements

- Which contracts are leases?
- Which transition options to choose?
- Database of all leases?
- Systems and processes in place?
- What about ratios and covenants?

KPMG Enterprise

Public Sector Accounting ("PSA") Standards Update

Public Sector - Applicable Standards

Public Sector Organizations

- **Governments**
  - **CPA Canada PSA Handbook**
- **Government business enterprises**
  - **IFRS**
- **Government non-for-profit organizations**
  - **CPA Canada PSA Handbook (+/- Section 4200 series)**
- **Other government organizations**
  - **Either CPA Canada PSA Handbook or IFRS**

Overview of Current Changes to the Public Sector Accounting Standards – New Standards and Application Date

Topic	**Effective Date** years commencing on or after
Restructuring transactions (PS 3430)	April 1, 2018
Financial instruments (PS 3450)* Foreign Currency Translation (PS 2601)* Financial Statement Presentation (PS 1201)* Portfolio Investments (PS 3041)* (*must be adopted together)	April 1, 2021 For entities who previously applied Part V of CICA Handbook, Accounting - April 1, 2012
Asset Retirement Obligations (PS 3280)	April 1, 2021
Revenues (PS 3400)	April 1, 2022

KPMG Enterprise

Public Sector Accounting Standard Changes Restructurings PS 3430

- Establishes standards for recognizing and measuring assets and liabilities transferred in a restructuring
- Assets and liabilities to be measured at their carrying amount
- A restructuring transaction in the public sector differs from an acquisition as they generally include either no or nominal payment
- Compensation is recognized as an expense/revenue
- Effective for years commencing on or after April 1, 2018

KPMG Enterprise

Public Sector Accounting Standard Changes
Financial Instruments / Foreign Currency / Financial Statement Presentation

- Financial Instruments s3450 / Foreign Currency Translation s2601 / Financial Statement Presentation s1201
  - Must be applied at the same time
  - Financial Statement Presentation changes related to the statement of remeasurement gains and losses to be presented in a separate statement
- Effective Date
  - Effective for years commencing on or after April 1, 2021, extended from April 1, 2019 in March 2018, for all other organizations including municipal governments

Public Sector Accounting Standard Changes
Financial Instruments PS 3450

- Measurement/Recognition Principles
  - New Section PS 3450 Financial Instruments
  - Investments in equities that are traded in an active market and derivatives are measured at fair value, with changes recognized in operations
  - All other financial instruments are carried at cost or amortized cost
  - Option to record any financial instrument at fair value – Irrevocable election on initial recognition

Public Sector Accounting Standard Change Financial Instruments – Financial Statement Presentation

Statement of Remeasurement Gains and Losses

For the year ended December 31	20X1	20X0
Accumulated remeasurement gains and losses at beginning of year	$ xx	$ xx
Unrealized gains (losses) attributable to:		
Derivatives	xx	xx
Portfolio investments	xx	xx
Foreign exchange	xx	xx
Amounts reclassified to the statement of operations:		
Derivatives	xx	xx
Portfolio investments	xx	xx
Foreign exchange	xx	xx
Net remeasurement gains and losses for the year	xx	xx
Accumulated remeasurement gains and losses at the end of the year	$ xx	$ xx

Asset Retirement Obligations ("ARO")

- A formal standard PS 3280 on ARO's was released August 2018 covering:
  - Retirement obligations associated with tangible capital assets controlled by a public sector entity (assumption of responsibility not a requirement)
  - Legal obligations, including an obligation created by promissory estoppel
  - Includes solid waste landfill closure and post-closure liability (has resulted in the proposed amendment to withdraw Section PS 3270)
  - Asset retirement obligations associated with tangible capital assets that are in productive use and those that are no longer in productive use
- Effective date April 1, 2021. Earlier adoption is permitted.

PS 3280 - Asset Retirement Obligations

- Common retirement obligation examples:
  - Closure and post-closure obligations associated with landfills
  - Buildings with asbestos
  - Nuclear power plant decommissioning
  - Storage tank removal
  - Removal of radiologically contaminated medical equipment
  - Wastewater or sewage treatment facilities
  - Reclamation, closure and post-closure obligations associated with mining activities
  - Reforestation of land subject to a timber lease

ARO - Recognition / Allocation

- A liability should be recognized when, as at the financial reporting date:
  - there is a legal obligation to incur retirement costs in relation to a tangible capital asset;
  - the past transaction or event giving rise to the liability has occurred;
  - it is expected that future economic benefits will be given up; and
  - a reasonable estimate of the amount can be made.

- A liability for an asset retirement obligation cannot be recognized <u>unless all of the criteria above</u> are satisfied.

PS 3280 - Key Scoping Questions

1. Does the entity have a legal obligation to remove a tangible capital asset from service – in other words, retire the asset?
2. Does the entity control the tangible capital asset that needs to be retired?

Requires review of contracts and agreements, as well as legislation. Consider any promises that would be considered legally enforceable.

KPMG Enterprise

ARO - Recognition / Allocation

Recognition and allocation guidelines:

- Capitalize asset retirement obligation and allocate the cost in a rational and systematic manner.
- Capitalize vs. expense:
  - Capitalize asset retirement obligations associated with fully amortized tangible capital assets.
  - Expense asset retirement obligations associated with unrecognized tangible capital assets.
  - Expense asset retirement obligations associated with tangible capital assets no longer in productive use.

KPMG Enterprise

ARO - Measurement

- The estimate of a liability should include costs directly attributable to asset retirement activities.
- Costs would include post-retirement operations, maintenance and monitoring that are an integral part of the retirement of the tangible capital asset.

Revenues PS 3400

- PSAB approved the final Handbook Section PS 3400, *Revenue* in June 2018. This new Section will be effective for fiscal years beginning on or after April 1, 2022
  - Focused on two categories of revenues: exchange transactions; and unilateral (non-exchange) transactions
  - Exchange transactions are distinguished based on the presence of performance obligations (enforceable promises to provide goods or services)
  - An exchange transaction is evaluated to identify which goods or services are distinct and accounted for as a separate performance obligation
  - Revenue from an exchange transaction is recognized as the public sector entity satisfies a performance obligation
  - Unilateral revenues (such as fines and penalties imposed by a government) are recognized when there is the authority and a past event that gives rise to a claim of economic resources
  - Revenue is not reduced upon initial recognition if collectability is uncertain

PSAS Active Projects

Topic	Next steps
Employment benefits	Third Invitation to Comment, “Employment Benefits: Non-traditional Pension Plans.” issued October 2018. Responses due February 1.
Public private partnerships	Exposure Draft expected to be approved by PSAB in Q4 2019.
Concepts Underlying Financial Performance	SoC and SoP released Q2 2018

KPMG Enterprise

KPMG Enterprise

Trusts (Regulation of Trust Business) Act 2001

Trusts (Regulation of Trust Business) Act 2001

- **Pursuant to section 36(1) (b) of the Trusts (Regulation of Trust Business) Act 2001, (the "Act"), the Bermuda Monetary Authority ("BMA") requests that all licensed undertakings provide to the Authority a report of its compliance with the First Schedule to the Act.**
- **The scope of the report should include but not limited to:**
  - **Confirmation of the segregation of client monies from the monies of the trust undertaking;**
  - **Confirmation that client monies are held in clearly separate and distinct accounts from any accounts of the trust undertaking own monies;**
  - **The quality and completeness of disclosure to clients of the terms upon which client money is held;**
  - **The design and effectiveness of internal control to ensure that client money accounts are reconciled promptly by the trust undertaking;**
  - **The design and effectiveness of internal control to ensure that payment from client monies accounts adhere to a dual signature protocol; and**
  - **The adequacy of policies, procedures and controls to prevent the inappropriate use of client monies for the settlement of trust undertaking fees and disbursements.**

KPMG Enterprise

(continued) Trusts (Regulation of Trust Business) Act 2001

- **The Act requires that a third party perform the review**
- **The report should be in written format and may be prepared by the undertaking's independent auditor or by an accountant or other person with relevant skill in reviewing and assessing internal controls over the administering and holding of client monies.**
- **The report should cover at least 12 months and be provided to the BMA before, but no later than December 31, 2019.**

KPMG Enterprise

KPMG Enterprise

Questions?

Contacts

Steve Woodward
Managing Director, Enterprise

T: 1 441 294 2675
E: stevewoodward@kpmg.bm

Felicia Wilsen
Director, Enterprise

T: 1 441 294 2649
E: feliciawilsen@kpmg.bm

For Economic Substance Act

Michael Penrose
Senior Manager, Advisory

T: 1 441 294 2603
E: michaelpenrose@kpmg.bm

Sarah Robey
Senior Manager, Tax

T: 1 441 294 2701
E: sarahrobey@kpmg.bm

kpmg.com/socialmedia

kpmg.com/app