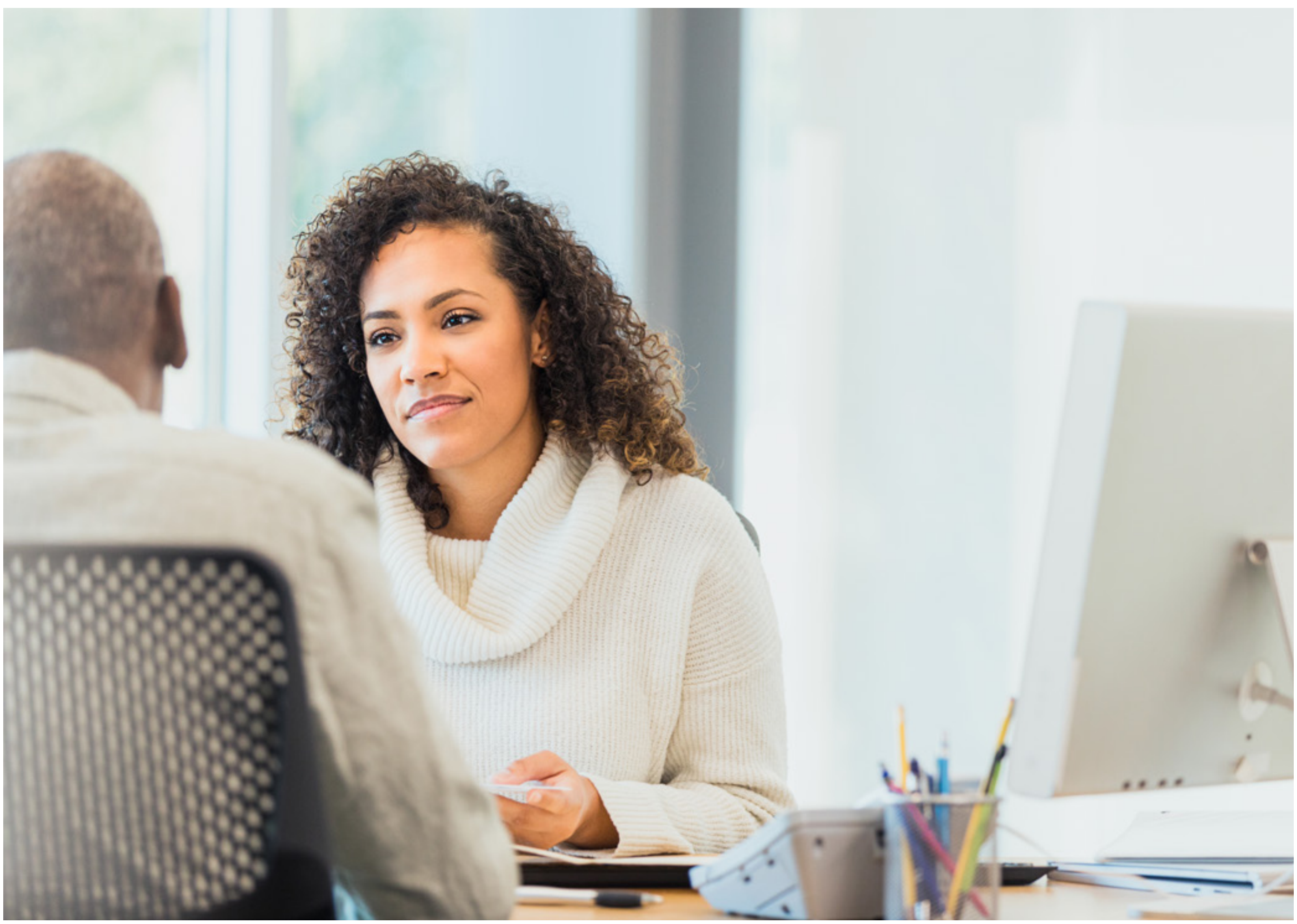
Keeping pace with changes to accounting standards and tax regulations

Several accounting standards and tax regulations are now on the cusp of change, some of which have remained unchanged for almost 30 years. For bankers, this may result in confusion, questions and concerns from clients—along with the need to revisit some of your processes and agreements. Advance preparation will be key to ensure your clients are well-informed and to effectively support their future growth and plans.



Here we highlight three key standards and regulations that are changing and explore how these changes may impact you.

New compilation engagement standards: CSRS 4200

CSRS 4200 results in new rules for compilation engagements with periods ending on or after December 14, 2021.

The previous standard (Section 9200 Compilation Engagements) referred to the issued report as a Notice to Reader and it was assumed that management was generally the only user of the compiled financial information. As a result, no disclosures or information were required to detail how the financial information was compiled.

The new CSRS 4200 standard acknowledges that compiled financial information is often shared with third party users, including banks and lenders. As such, the new standard was developed to consider the needs of all users of the financial information. This means your clients are now required to provide greater transparency regarding how the financial information is prepared. Specifically, the compiled financial information must now include a new note describing the basis of accounting used in preparing the compiled financial information, introducing a level of clarity that reports issued under Section 9200 lacked.

As a result of the note disclosure, third party users of the compiled financial information can:

- understand how the financial information was compiled; and
- determine how specific items were accounted for *(e.g., using a cash basis, a cash basis with selected accruals and accounting estimates, or other basis of accounting prescribed by contract).*

What does this mean for bankers?

The change in standards allows third party users to explore new contracts, and revisit existing ones, to refine and clearly define their needs with respect to the financial information provided by their clients. Bankers should assess their needs and client risk factors to determine if a compilation engagement is appropriate. For instance:

- If a third party requires a prescribed level of assurance or procedures pertaining to the accuracy and completeness of financial information, they should consider a review or audit engagement instead as compilation engagements do not provide any assurance.
- If a compilation engagement is appropriate, third-party users should discuss with their clients if they can access additional information other than the compiled financial information.
  - If the third party does have access to additional information, then management and the third party do not need to agree on the basis of accounting.
  - If the third party does not have access to additional information, then management and the third party must agree on the basis of accounting used to compile the financial information.

Ultimately, discussions should occur between bankers and their clients surrounding the type of engagement required, access to information and the basis of accounting that meets the bankers' needs.

Retractable or redeemable shares: ASPE 3856

Another set of amendments that will likely raise questions and create process changes for bankers is ASPE 3856, which deals with financial instruments pertaining to retractable or mandatorily redeemable shares (ROMRS) issued in a tax planning arrangement. While not defined in ASPE, common examples of tax planning arrangements include:

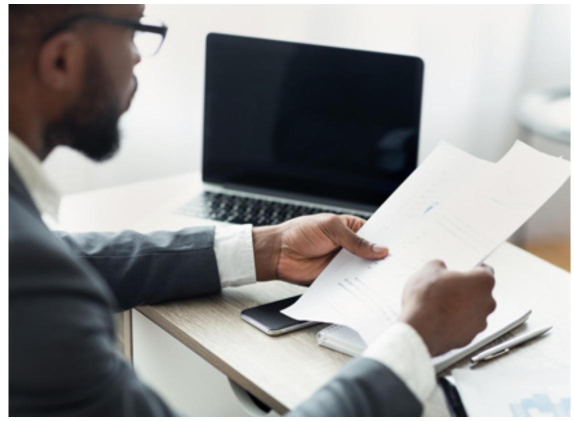
- Share exchanges
- Wind-ups
- Amalgamations
- Asset transfers or roll-overs
- Estate freezes

Because their intent is to defer, minimize or crystallize tax, these types of arrangements often contemplate the issuance of redeemable preferred shares that give the shareholder the right to demand cash or another financial asset from the company. As such, they have traits of both liabilities and equity. Historically, these were recorded as a liability unless they were issued through one of the tax planning arrangements noted above.

The most recent amendment limits the exception further by allowing companies to record preferred share issuances as equity instruments only if they meet three conditions:

- control of the enterprise issuing the ROMRS is retained by the shareholder receiving the shares in the arrangement;
- no consideration other than shares is received by the enterprise issuing the ROMRS; and
- no written or oral arrangement exists, such as a redemption schedule, which gives the holder of the shares the contractual right to require the enterprise to redeem the shares on a fixed or determinable date or within a fixed or determinable period.

The application of this exception is now optional—which means entities can still choose to present ROMRS as liabilities even if they meet the requirements above.



What does this mean for bankers?

If an entity is required to reclassify their ROMRS from equity to liabilities, their covenant calculations may change drastically. These amendments are effective for fiscal periods beginning on or after January 1, 2021 and must be applied retrospectively, meaning your clients and their accountants will need to assess ROMRS issued in the past to determine how they should be classified under the amended standards. To avoid significant and unintended covenant breaches, it's consequently imperative for bankers to look at client lending agreements and put internal processes into place to accommodate client requests for changes to their banking agreements.

Intergenerational share transfers: Bill C-208

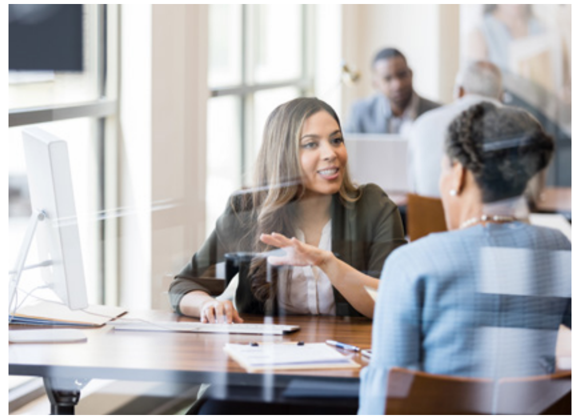
Yet another change that may affect client tax considerations is the private member's bill introduced in Parliament known as Bill C-208.

Prior to the bill, intergenerational business transfers could be subject to dividend tax rates, rather than the lower capital gains tax rates or capital gains exemptions that apply on third-party sales. As a result, sales to a third party were more tax advantageous than those to family members, such as children or grandchildren. In some cases that resulted in a tax burden of more than 47 percent, depending on the province in which the transaction was occurring.

To remove these punitive conditions, Bill C-208 allows certain intergenerational transfers to be treated in the same way as third-party sales if the transfers are Qualified Small Business Shares (from an active business) or Qualified Fishing and Farming Corporations;

- taxable capital is below $15 million;
- vendor is either a parent or grandparent;
- shares are held for a minimum of five years after sale; and
- price of the shares is supported by a third-party valuation.

There's only one catch: there's a general consensus in the accounting industry that these rules may be perceived as making intergenerational transfers too tax advantageous. As a result, they may tighten up before they are finalized.



What does this mean for bankers?

Right now, an opportunity exists for business owners to take advantage of the capital gains exemptions and lower tax rates allowed for in the bill. However, time is not necessarily on the business owner's side. Bankers may want to take this window of opportunity to communicate with clients contemplating selling their businesses to the next generation, or to those thinking about retirement, to encourage them to act now if they are ready to sell.

Preparation is the key

Standards and rule changes in the tax code take time to assess and are bound to create both challenges and opportunities for clients needing assistance. By clarifying your internal processes and client communication protocols in advance, you can set both your organization and your clients up for success.

If you would like assistance assessing the impact of these changes on your organization, contact your Grant Thornton advisor.

Grant Thornton

Audit | Tax | Advisory

About Grant Thornton LLP in Canada

Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. We help dynamic organizations unlock their potential for growth by providing meaningful, actionable advice through a broad range of services. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member and correspondent firms operate in over 100 countries worldwide.