January 29, 2018

Rebecca Villmann, CPA, CA, CPA (Illinois)
Director, Accounting Standards
Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2

Dear Ms. Villmann:

Re: Accounting for Related Party Financial Instruments and Significant Risk Disclosures Exposure Draft (ED)

Thank you for the opportunity to comment on the above-noted document. MNP LLP (MNP) is one of Canada's largest chartered professional accountancy and business advisory firms, with a significant focus on clients in private enterprises. We believe that we are positioned well to provide feedback on this important issue.

We have reviewed the document and have provided our comments below. Overall, we are pleased to see that this Exposure Draft is addressing the confusion related to the interaction between Section 3840 *Related Party Transactions* and Section 3856 *Financial Instruments* on the accounting for related party financial instruments. However, we still have several concerns. We have also identified some areas that we believe could be further clarified and/or expanded upon to assist in the consistent application of the finalized standards.

Question 1: Do you agree that locating the initial measurement guidance for related party financial instruments in Section 3856 clarifies how the Section applies to the accounting for related party financial instruments? If not, why not?

We agree that providing initial measurement guidance for related party financial instruments in Section 3856 clarifies how the Section applies to the accounting for related party financial instruments. However, we are concerned that where financial and non-financial assets or liabilities exist in the same related party transaction, navigating between Section 3856 and Section 3840 is still required. Enterprises will have to refer to Section 3840 for the initial measurement of the non-financial instrument(s) exchanged in a transaction involving a related party financial instrument. We believe the requirements for the accounting for all related party instruments, whether financial or non-financial, would be much easier to follow and apply if they were all located in Section 3840.

Should the proposal be implemented as drafted, we believe that the Illustrative Examples in Section 3856 should also provide reference to the Section 3840 requirements, in order to clarify the interaction between the two sections and provide full illustration of the accounting for a transaction involving both financial and non-financial related party instruments.

Question 2: Do you agree that the proposed consequential amendments to Section 3840 clarify how non-financial assets and non-financial liabilities (i.e., the assets and liabilities that are not in the scope of Section 3856) should be accounted for? If not, why not?

We agree that the proposed consequential amendments will be sufficient to clarify the accounting treatment for non-financial related party instruments.

Question 3: Do you agree that the initial cost of a related party financial instrument with repayment terms should be determined using the undiscounted cash flows of the instrument, excluding interest and dividends? If not, why not?

We agree that the initial cost of a related party financial instrument with repayment terms should be determined using the undiscounted cash flows of the instrument, excluding interest and dividends. This eliminates the requirement for related parties to determine a market rate for a transaction which is difficult as related parties do not necessarily transact at fair value. However, we are concerned that some enterprises may confuse the repayment terms requirement to include only those related party financial instruments with scheduled repayments. We recommend that the proposed amendments clarify that related party financial instruments, such as notes and loans receivable or payable, with no stated repayment terms are deemed to be payable on demand. Thus, these instruments are considered to have repayment terms for the purposes of Section 3856. We believe this guidance, which is provided in the explanatory text to Illustrative Example 1, would be best included in paragraph 3856.A8A of Appendix A.

Question 4: Do you agree that the initial cost of related party financial instruments without repayment terms should be determined as described in proposed paragraph 3856.08A(b)? If not, why not?

We agree that the proposed initial measurement will simplify the accounting and create consistency in application. However, this measurement method requires an enterprise to refer to Section 3840 for application guidance on what constitutes commercial substance, a substantive change in ownership and independent evidence. With the purpose of eliminating the continued interaction between Section 3840 and Section 3856, we recommend that the requirements for the accounting for all related party instruments, whether financial or non-financial, be located in Section 3840.

Question 5: Do you agree that both investments in equity instruments of related parties that are quoted in an active market and derivative contracts with related parties should be initially and subsequently measured at fair value? If not, why not?

We agree that fair value measurement for these items provides the most relevant information to financial statement users of the enterprise’s financial position. Further, we believe fair value measurement is not overly onerous to apply to these items.

Question 6: Do you agree that an enterprise should be prohibited from electing to subsequently measure related party financial instruments at fair value? If not, why not?

Based on the same reasoning for our agreement with the proposed initial measurement guidance in Questions 3 & 4, we agree that an enterprise should be prohibited from electing to subsequently measure related party financial instruments at fair value. This also allows for better comparability between the financial statements of private enterprises.

Question 7: Do you agree that an enterprise should be permitted to initially measure the equity component of a related party compound financial instrument as zero? If not, why not?

We believe the option to value the equity component of a compound financial instrument as zero would resolve much of the complexity in accounting for related party compound financial instruments.

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Question 8: Do you agree that an enterprise should first assess for, and recognize in net income, any impairment of a related party financial asset before a forgiveness of that financial asset is recognized? If not, why not?

We agree that an enterprise should first assess for, and recognize in net income, any impairment of a related party financial asset before a forgiveness of that financial asset is recognized. However, we have noted in practice that enterprises find it difficult to distinguish between impairment and forgiveness of related party financial assets. We believe that additional guidance on factors to consider in making the determination of impairment versus forgiveness would result in greater consistency in applying the proposed guidance.

Question 9: Do you agree that an enterprise should recognize the forgiveness of related party financial assets in:

(a) Equity, when the original transaction that resulted in acquiring the asset was not in the normal course of operations; or

(b) Net income when the original transaction that resulted in acquiring the asset was in the normal course of operations or when it is impracticable to determine whether the amount forgiven originated in the normal or not in the normal course of operations?

If not, why not?

We do not agree. There may be instances where the origination of a related party receivable was in the normal course of operations, however, the decision to forgive the amount is outside the normal course of operations. Further, related party receivables often include a blend of accounts receivable from sales transactions occurring in the normal course of operations and loans receivable from financing which are not in normal course of operations. Therefore, it would be difficult to differentiate which portion of the related party receivable was, or was not, in the normal course of operations. Also, questions may arise as to when the repayment terms of a related party receivable, originating from a normal course sale, become too different from normal operations that it would indicate that the loan is outside the normal course of operations. In all these situations, the loss on forgiveness would be recognized in net income for a forgiveness decision which is outside the normal course of operations. The proposed recognition of the loss on forgiveness doesn't consider the fact that the nature of the origination of the related party asset is separate from the nature of the terms of the asset carried and the subsequent decision to forgive.

In addition, some related party asset balances may relate to transactions that were originated a number of years ago. Lack of documentation from long-standing transactions may make it difficult to determine whether the original transaction was in the normal course of operations.

We recommend classifying all related party asset forgiveness as transactions outside the normal course of operations, regardless of the source of the original asset recognized. To prevent difficulty and confusion in application, and promote consistency in practice, the loss on the forgiveness of all related party assets should be recognized through equity.

Question 10: Do you agree that NFPOs should be excluded from the scope of paragraph 3856.19A? If yes, do you think that NFPOs need guidance on how to account for the forgiveness of related party financial assets?

In our experience, it is not common for NFPOs to forgive related party financial assets. However, if such transactions did occur, NFPOs would be left without guidance on recognition of the forgiveness. We believe that guidance should be included for NFPOs within Part III of the CPA Canada Handbook - Accounting. Consistent with our response to Question 9, we believe NFPOs should recognize all related party asset forgiveness directly in net assets.

Question 11: Do you agree that accounting for all modifications of related party financial liabilities as an extinguishment of the original financial liability and the recognition of a new financial liability, would simplify the accounting for these transactions? If not, why not?

We agree with this simplification and agree that the criteria in Section 3856.A52 is difficult to apply in relation to related party financial liabilities. We agree with the Private Enterprise Advisory Committee that the guidance in Section 3856.A52 is also difficult to apply to arm's length financial liabilities and would support the Board undertaking a project in this regard. For example, while changes to interest rates and repayment schedules are easily assessed, treatment of non-cash features is difficult.

Question 12: Do you agree that an enterprise need not disclose significant risks arising from derivatives separately from risks arising from other financial instruments? If not, why not?

We agree that this disclosure simplification will ease the burden of drafting financial statement risk disclosures for private enterprises. We also agree that financial statement users would not be negatively impacted by removal of separate disclosure requirements for derivative instruments.

Question 13: Do you agree that the proposals should be applied retrospectively in accordance with ACCOUNTING CHANGES, Section 1506, with simplified transitional provisions? If not, why not?

We agree that retrospective application will best maintain the comparability of the financial periods presented. Further, we agree that the simplified transitional provisions permit private enterprises to apply the amendments without undue cost or effort.

Question 14: Do you agree with the proposed effective date (i.e., fiscal years beginning on or after January 1, 2020)? If not, why not?

We agree that the proposed effective date will permit private enterprises sufficient transitional time, subject to the final amendments being issued in Q4 of 2018. If any significant delays occur to the final issuance of the amendments, we believe the board should at that time re-assess the acceptability of the effective date.

We are pleased to offer our assistance to the AcSB in further exploring issues raised in our response and in helping to find alternative solutions which meet the needs of financial statement users.

Yours truly,

MNP LLP

Jody MacKenzie

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Director, Assurance Professional Standards