

CHAPTER 13: NON-FINANCIAL AND CURRENT LIABILITIES

1. Definitions, Recognition and Measurement

Definitions

Liability: An obligation that arises from past transactions or events, which may result in a transfer of assets or provisions or services.¹

The CPA Canada Handbook² specifies a liability exists when the following 3 conditions are true:

1. The entity has a duty of responsibility,
2. The entity has no discretion to avoid said responsibility, and
3. The transaction giving rise to said responsibility has happened.

Current liabilities: Amounts payable within one year of the date of the balance sheet or within the normal operating cycle if the operating cycle is longer than one year.

Financial Liabilities: Contractual obligations to deliver cash and/or other financial assets to another party, or to exchange financial instruments with another party under conditions that are potentially unfavorable.

Non-financial Liabilities: Obligations that are usually not payable in cash. Generally these obligations are settled vis-à-vis the delivery of particular goods and/or services. If any liability will be met by the delivery of goods or services (like unearned revenue and warranty obligations), it is not considered a financial liability.

Accounting and Measuring Current Liabilities

Financial liabilities are measured and recognized at their *maturity value* – which is a contractually specified amount. In contrast, non-financial liabilities are measured at an *exit-based-value*. This exit-based amount is the value of the goods and/or services – which will be delivered in the future – to satisfy the obligation.³

2. Common Current Liabilities

Bank Indebtedness and Credit Facilities

Companies commonly establish a line of credit or revolving debt arrangements with their financial institution(s). These arrangements allow companies to borrow money from a financial institution without constantly renegotiating the borrowing terms. A company's borrowing limit is generally a function of its current assets. These assets serve as collateral. (Amounts reserved as collateral must be disclosed in the notes accompanying the financial statements.)

Accounts Payable

Accounts payable signify any amounts a company owes to other entities for the purchase of goods, supplies, and/or services, and these purchased items relate to the company's ordinary business activities. The company purchases these items from vendors on an open account. Payables generally arise due to the lag-time between (1) the point, whereby the company receives the goods, supplies, and/or services, versus (2) the point, whereby the company pays for these things. The company needs to be aware of vendor trade terms, namely the cut-off point for potential discounts.

¹ Excerpt retrieved from page 811 of the textbook.

² Refer specifically to the CPA Canada Handbook - General Accounting Section 1510 ("Current Assets and Current Liabilities"). Also see International Accounting Standard 37 (IAS 37) ("Provisions, contingent liabilities and contingent assets"). These resources are on Moodle.

³ Note: IAS 37 provides more specific guidance on the measurement process.

Notes Payable

Notes payable are written promises made by the company to pay a certain sum of money, on a specified date, to a third party. There are both short-term and long-term notes payable, and there are both interest-bearing and non-interest bearing notes payable. Notes payable often bear a strong resemblance to cash loans. The company often accounts for short-term notes at face-value even though it receives an amount less than face-value. The difference between the face-value of the note and the cash loaned to the company is treated as interest expense.

Current Maturities of Long-Term Debt

Long-term debt includes things like bonds and mortgages. Any portion of long-term debt that is slated to mature in the next 12 months is re-classified as a current liability on the SFP. However this reclassification is not done in the event the currently-maturing debt is settled with long-term assets.

Short-Term Debt Expected to be Refinanced (Illustration: E13-8)

Sometimes a company refinances short-term debt by issuing long-term debt and/or equity. The IFRS and ASPE frameworks provide specific guidance to preparers on the conditions, whereby short-term debt expected to be refinanced can be re-classified as a long-term obligation on the SFP.

International Financial Reporting Standards: S/T Debt Expected to be Refinanced

The only time a company can classify short-term debt expected to be refinanced as a long-term obligation "...is if, at the date of the statement of financial position, the entity expects to refinance it or roll it over under an existing agreement for at least 12 months and the decision is solely at its discretion."⁴

Accounting Standards for Private Entities: S/T Debt Expected to be Refinanced

A company can classify short-term debt expected to be refinanced as a long-term obligation when "...either the liability has been refinanced on a long-term basis or there is a non-cancellable agreement to do so before the financial statements are completed..."⁵

To sum up: "...IFRS has a more stringent requirement; the agreement must be firm at the date of the statement of financial position."⁶ ASPE, on the other hand, requires the refinancing agreement to be in place before the financial statements are issued.

Disclosures should be provided in the notes accompanying the financial statements in the event any short-term debt is reclassified on the SFP. A typical example of a note disclosure can be seen in part A. of E13-8.

Dividends Payable

A current liability is recognized immediately when the Board of Directors declares a dividend. It is worth noting that dividends in arrears do not constitute a liability. However the company is required to provide details on any dividends in arrears in the notes accompanying the financial statements. It is also worth noting that stock dividends are not recognized as a current liability because they do not give rise to the disbursement of assets.

Customer Advances and Deposits

Customer advances (e.g., damage deposit) and employee deposits (e.g., deposits for keys) received by the company are regarded as current liabilities in certain cases, like in the case a company does not have the right to defer the settlement of the deposit/advance for a period of at least 12 months from the date of the statement of financial position.

⁴ Retrieved from page 817 of the textbook.

⁵ Retrieved from page 818 of the textbook.

⁶ Retrieved from page 818 of the textbook.

Taxes Payable

Sales Tax – GST (5%), HST⁷, QST (9.975%)

Companies collect sales tax when they sell goods/services. Conversely, they pay sales tax when they make valid business expenditures. They receive a rebate from tax authorities for any GST, HST, and QST paid in relation to valid business expenditures. And this rebate takes the form of a receivable on the SFP. One important note here: Companies do not receive a rebate for any provincial tax paid on business-related expenditures. Companies are obliged to remit GST, HST, QST and provincial tax collected from customers to the pertinent tax authorities. A payable is recognized on the SFP for accounting purposes. And the value of this payable is equal to the collected amounts that have yet to be remitted to the pertinent tax authorities. In practice, the net balance of the receivable and the payable is reported on the SFP, and details on the two accounts are provided in the notes accompanying the financial statements.

Income Tax

Companies are required to pay provincial and federal tax on taxable income. In practice, they make quarterly installment payments to the applicable tax authorities, and the value of these installments is based on the best information/advice available to the company. In practice, the value of the installments is generally based on the company's prior-year taxable income.

Employee-Related Liabilities

Payroll Deductions⁸

Companies deduct certain amounts, like CPP/QPP and EI, from their employees' pay-checks. Any amounts deducted by the company – which have yet to be remitted to the proper authority by the end of the accounting period – are recognized as current liabilities on the SFP.

Profit-Sharing and Bonus Agreements

These amounts are accounted for in much the same way salaries payable are handled. Any outstanding amounts related to a profit sharing or bonus plan are reported as a current liability on the SFP until these amounts are disbursed to employees.

Non-Accumulating Rights to Benefits

Employees are often entitled to receive particular benefits, like paternity leave, from the employer. But the employee does not automatically accumulate these benefits by working for the organization. As an example, a male professor is not entitled to receive paternity leave from the John Molson School of Business unless his wife/partner gives birth to a baby. Consequently, organizations do not accrue non-accumulating benefits. There is one exception though. An organization will recognize a liability (along with the related expense) in the event that an employee provides notice to HR about their intention to apply for particular benefits, such as paid maternity/paternity leave, in the near future.

Accumulating Rights to Benefits (Illustration: E13-10)

Employees automatically accumulate certain benefits when they provide services to the employer. *Vacation pay* and *sick pay* are two examples of accumulating benefits to the extent that the employer has an *unconditional obligation* to disburse these benefits to employees as soon as employees earn them. Both vacation pay and sick pay can either be *vested* or *non-vested*. The employer is obliged to pay vested benefits employees even after employees cease to work for the employer. In contrast, the employer is only obliged to pay *non-vested* benefits to current employees.

⁷ Used in provinces – like Nova Scotia – where the federal Goods and Services Tax (GST) and the regional Provincial Sales Tax (PST) have been combined into a single value added sales tax. The HST is 15% in Nova Scotia, whereby 5% relates to the GST and 10% relates to provincial taxes.

⁸ Please refer to pages 822 to 823 for more comprehensive analyses of payroll deductions.

The accounting treatments for vacation pay and sick pay are relatively congruent.⁹ The following example pertains to the accounting for vacation pay. The employer accrues vacation pay in the period, wherein employees earn these benefits, and it records this journal entry:

<i>Salaries and Wages Expense</i>	<i>xxx</i>	
<i>Vacation Wages Payable</i>		<i>xxx</i>

It is worth emphasizing that a company accrues vacation pay at the employee's current wage-level; that is, the rate at which employees are compensated in the periods, wherein they earn vacation-pay-related-benefits.

The company prepares this journal entry when it disburses vacation pay to employees:

<i>Vacation Wages Payable</i>	<i>xxx</i>	
<i>Cash</i>		<i>xxx</i>

The value of benefits disbursed (as cash) to employees is based on the wage-level in effect during the period, wherein the benefits are disbursed. The above entry reflects a situation, whereby there is no change in the wage-rate. But if there is a change in the wage-rate between (1) the date, whereby the company accrues the obligation, and (2) the date, whereby the company disburses benefits to employees, then the company prepares one of the following two journal entries.

Scenario #1: The company prepares this journal entry when the wage-rate increases:

<i>Vacation Wages Payable</i>	<i>xxx</i>	
<i>Salaries and Wages Expenses</i>	<i>xxx</i>	
<i>Cash</i>		<i>xxx</i>

Scenario #2: The company prepares this journal entry when the wage-rate decreases:

<i>Vacation Wages Payable</i>	<i>xxx</i>	
<i>Salaries and Wages Expenses¹⁰</i>		<i>xxx</i>
<i>Cash</i>		<i>xxx</i>

Vacation wages payable is written-down by an amount that is based on the wage-rate paid to employees when the company originally accrued the obligation. The difference between the original wage rate and the future rate manifests as either a debit or credit to salaries and wages expense.

One important note here: The company writes off the oldest accumulating benefits first. The accounting for accumulating benefits bears some resemblance to a FIFO inventory system. To illustrate this point, if employees accumulate benefits in years 1, 2, and 3, respectively, then, the company reduces the vacation-pay-related-obligation by first reducing it by the value of the benefits earned by employees in year 1, next by the value of the ones earned by employees in year 2, and finally by the value of the ones earned by employees in year 3. It is particularly important for the company to write-off the oldest accumulating benefits first in those cases where the wage-level changes.

3. Accounting for Non-Financial Liabilities

Decommission and Restoration Obligations (ARO) (Illustration: E13-14)

An *asset retirement obligation* is an existing legal obligation associated with the retirement of a tangible long-lived asset that results from its acquisition, construction, development, or normal operations. The future obligation is recognized on the SFP in the period, whereby the company acquires the long-term asset. There are several journal entries made by a company in relation to an ARO.

⁹ Although it is worth noting that employees are not entitled to receive vacation pay until they have worked for a particular length of time for the company, whereas employees, in virtually all cases, are entitled to receive sick pay immediately.

¹⁰ A credit is never made to Retained Earnings since the discrepancy is not the result of a prior-period error.

A company records this journal entry, in year #1, when it purchases the long-term asset, whereby the value of the long-term asset is equal to the consideration exchanged:

<i>Long-Term Asset (e.g., pump jack)</i>	<i>xxx</i>	
<i>Cash</i>		<i>xxx</i>

Next, the company records the present value of the future obligation of dismantling and removing the long-term asset, and more specially the costs associated with acquiring the long-term asset. The company prepares this entry in year #1, and it prepares this journal entry on exactly the same date as the one it acquires the long-term asset:

<i>Long-Term Asset (e.g., pump jack)</i>	<i>xxx</i>	
<i>ARO</i>		<i>xxx</i>

One important note here: The company does not add the costs of using the long-term asset (i.e., production costs) to the value of the ARO on the date the ARO is initially recognized.

The company depreciates the long-term asset at the end of every year (including at the end of year #1) by recording this journal entry:

<i>Depreciation Expense</i>	<i>xxx</i>	
<i>Accumulated Depreciation</i>		<i>xxx</i>

Please Note: The company does not depreciate the long-term asset for an entire year in year #1 if it purchases the long-term asset midway through year #1.

An ARO is one type of discounted debt. The value of an ARO (like any discounted debt) is, therefore, adjusted at the end of each year in a reflection of the time value of money. The company increases the value of the ARO each year by an amount = $\text{ARO Balance} \times \text{Discount Rate} \times \text{Time}$. The company increases the value of the ARO by this amount each year to ensure the value of the ARO – that is, the amount that will be recognized on the SFP on the settlement date – is commensurate with the costs incurred to remove and dismantle the long-term asset on the settlement date. Bearing this in mind, the company prepares this journal entry if it is IFRS-compliant:

<i>Interest Expense</i>	<i>xxx</i>	
<i>ARO</i>		<i>xxx</i>

Conversely, the company prepares this journal entry if it is ASPE-compliant:

<i>Accretion Expense</i>	<i>xxx</i>	
<i>ARO</i>		<i>xxx</i>

Please Note: The values seen in the two entries above are exactly the same. The only difference between them is the name of the account that is debited (i.e., Interest Expense vs. Accretion Expense).

The company also increases the value of the ARO at the end of each year by an amount equal to the costs of using the long-term asset. Bearing this point in mind, the company prepares this journal entry if it is IFRS-compliant:

<i>Inventory</i>	<i>xxx</i>	
<i>ARO</i>		<i>xxx</i>

Conversely, the company prepares this journal entry if it is ASPE-compliant:

<i>Long-Term Asset (e.g., drilling platform)</i>	<i>xxx</i>	
<i>ARO</i>		<i>xxx</i>

Please Note: The values seen in the two entries above are exactly the same. The only difference between them is the name of the account that is debited (i.e., Inventory vs. Long-Term Asset).

The company eventually prepares this journal entry on the settlement date, whereby it pays all costs associated with safely removing and dismantling the long-term asset:

<i>ARO</i>	<i>xxx</i>	
<i>Cash</i>		<i>xxx</i>

One important note here: If the value of the ARO \neq Cash, then a Gain/Loss is recognized for an amount equal to $|\text{ARO} - \text{Cash}|$.

Unearned Revenue

The principle of revenue recognition requires a company to report income when it earns income rather than when cash is exchanged. Consequently the company prepares this journal entry whenever it receives cash for revenue it has yet to earn:

<i>Cash</i>	<i>xxx</i>	
<i>Unearned Revenue</i>		<i>xxx</i>

The company prepares this journal entry when it eventually earns the revenue:

<i>Unearned Revenue</i>	<i>xxx</i>	
<i>Revenue</i>		<i>xxx</i>

Product Guarantees and Customer Programs

This set of obligations includes product guarantees and warranty obligations, customer loyalty programs, premiums and rebates, and so on. There are two methods of accounting for these liabilities and their associated expenses.

Method #1: Revenue Approach

Under this approach, a portion of the cash received by the company from customers is recognized as unearned revenue. That is, when the company sells merchandise – along with any accompanying product guarantees and customer programs – and the company recognizes a portion of the cash proceeds as earned revenue and unearned revenue, respectively.

The revenue approach resonates with the principle of revenue recognition because it is based on the presumption that a portion of the cash collected by the company from customers signifies unearned revenue. “Until the revenue is earned, the obligation—the liability—is reported at its sales or fair value. The liability is then reduced as the revenue is earned.”¹¹ This approach can be juxtaposed with the expense approach, whereby all cash proceeds collected by the company are recognized immediately as earned revenue.

This treatment sees the company:

- Record a portion of the collected proceeds as earned revenue and unearned revenue → Debit Cash, Credit Sales, and Credit Unearned Revenue.
- Recognize unearned revenue as sales revenue at some future point, whereby the company earns said revenue by providing particular services (say by providing warranty repair work) to customers → Debit Unearned Revenue, Credit Sales Revenue.

One important note here: IFRS mandates application of the revenue approach in most cases.

¹¹ Retrieved from page 831 of the textbook.

Method #2: Expense Approach

Under this approach, the liability (say the warranty obligation instance) is measured/recognized by the company at an amount that is equal to the economic resources needed to satisfy the obligation (i.e., output value). The company estimates and recognizes the liability/expense in the period, wherein the company sells merchandise (including their associated warranties, rebates, etc). Significantly, though, the company reports all cash collected from customers as earned revenue.

The expense approach resonates with the matching principle in the way the company matches and recognize sales and their associated expenses in the same period. It is worth emphasizing the company has two options for estimating/accruing the obligation, and the two options are elaborate in the subsequent section on the accounting for premiums and rebates, which are a specific type of *Product Guarantee and Customer Program*.

One point warrants emphasis here: The expense approach is less pervasive than the revenue approach in practice now. But the expense approach is still permitted by capital market regulators (namely the Ontario Securities Commission) when companies apply ASPE.

Premiums and Rebates (Illustration: P13-13)

A company may offer particular product benefits – like free merchandise, cash discounts, and so on – to customers as they collect and redeem coupons, box tops, wrappers, and so forth. The accounting treatment for premiums/rebates varies depending on whether the revenue approach or the expense approach is applied by the company.

Method #1: Revenue Approach (IFRS)

A company purchases a stock of inventory (i.e., rewards) intended to be disbursed to customers as customers collect and redeem coupons, box tops, wrappers, and so forth. The inventory is recorded at cost. The company prepares this journal entry when it purchases inventory in year #1:

<i>Inventory of Premiums</i>	<i>xxx</i>	
<i>Cash or A/P</i>		<i>xxx</i>

The company sells merchandise to customers in year #1. Coupons, box tops, wrappers, and so forth are attached to these merchandise. The company prepares this journal entry at the point of sale (i.e., year #1):

<i>Cash</i>	<i>xxx</i>	
<i>Sales Revenue</i>		<i>xxx</i>
<i>Unearned Revenue</i>		<i>xxx</i>

Note #1: A portion of the cash collected is reported as unearned revenue in the above journal entry. This revenue is considered unearned until the company distributes rewards to customers. The assumption made here is that the company has not earned a portion of the proceeds collected from customers until the company disburses rewards to customers. Expressed differently, the assumption observed here is that the customers would not have purchased the merchandise had they not been incentivized to do so vis-à-vis the company's disbursement of rewards.

As customers eventually redeems coupons, box tops, wrappers, and so forth in exchange for rewards, the company prepares this journal entry to recognize the expense associated with the rewards granted to customers:

<i>Premium Expense</i>	<i>xxx</i>	
<i>Inventory of Premiums</i>		<i>xxx</i>

At the same time the company prepares the above entry, it records this entry to recognize previously unearned revenue as sales revenue:

<i>Unearned Revenue</i>	<i>xxx</i>	
<i>Sales Revenue</i>		<i>xxx</i>

Method #2: Expense Approach (ASPE)

There are a couple of ways of applying the expense approach in relation to the accounting for premiums and rebates.

Approach #1

This approach sees the company charge the full estimated cost of the premium plan to expense when sales are recognized. Expressed differently, the company recognizes the obligation and associated expense immediately, and then writes it down as the company fulfills the obligation, for instance, by completing warranty work on deficient products.

The following journal entries are made by the company.

A company purchases a stock of inventory (i.e., rewards) intended to be disbursed to customers as customers collect and redeem coupons, box tops, wrappers, and so forth. The inventory is recorded at cost. The company prepares this journal entry when it purchases inventory in year #1:

<i>Inventory of Premiums</i>	<i>xxx</i>	
<i>Cash or A/P</i>		<i>xxx</i>

The company sells merchandise to customers in year #1. Coupons, box tops, wrappers, and so forth are attached to these merchandise. As noted above, the company recognizes all cash received from customers as sales revenue in this journal entry:

<i>Cash</i>	<i>xxx</i>	
<i>Sales Revenue</i>		<i>xxx</i>

Next the company records the full expected obligation/cost of the premium plan. Please note: the entry illustrated next is prepared by the company before customers redeem coupons, box tops, wrappers, and so in exchange for rewards. This is the entry is made by the company:

<i>Premium Expense</i>	<i>xxx</i>	
<i>Estimated Liability for Premium</i>		<i>xxx</i>

Finally, the company prepares a journal entry at the end of year #1 in a reflection of the coupons, box tops, wrappers, etc. redeemed by customers for rewards.

The company adjusts the accrued liability – that is, in a reflection of the extent to which it satisfied the obligation over the course of the year – vis-à-vis this journal entry made at year-end:

<i>Estimated Liability for Premium</i>	<i>xxx</i>	
<i>Inventory of Premiums</i>		<i>xxx</i>

Approach #2

The second approach sees the company charge the cost of the coupons to expense as they are redeemed by customers in year #1. Then the company estimates all further costs it expects to incur as customers redeem coupons, box tops, wrappers, and so forth in future years. The following journal entries are made by the company.

A company purchases a stock of inventory (i.e., rewards) intended to be disbursed to customers as customers collect and redeem coupons, box tops, wrappers, and so forth. The inventory is recorded at cost. The company prepares this journal entry when it purchases inventory in year #1:

<i>Inventory of Premiums</i>	<i>xxx</i>	
<i>Cash or A/P</i>		<i>xxx</i>

The company sells merchandise to customers in year #1. Coupons, box tops, wrappers, and so forth are attached to these merchandise. But in its application of ASPE (i.e., the expense approach), the company does not recognize an obligation at the point of sale (year #1).¹² Instead, it recognizes all cash received from customers as sales revenue in this journal entry:

<i>Cash</i>	<i>xxx</i>	
<i>Sales Revenue</i>		<i>xxx</i>

A portion of customers eventually redeems coupons, box tops, wrappers, and so forth in exchange for rewards in year #1. The company prepares this journal entry at the point of redemptions (year #1):

<i>Premium Expense</i>	<i>xxx</i>	
<i>Inventory of Premiums</i>		<i>xxx</i>

Then, the company estimates the value of the remaining obligation and the associated expense at the end of year #1. The company prepares this journal entry¹³ at year-end:

<i>Premium Expense</i>	<i>xxx</i>	
<i>Estimated Liability for Premium</i>		<i>xxx</i>

Contingencies, Uncertain Commitments, and Requirements for Guarantees and Other Commitments (Illustration: P13-17)

Contingencies and Uncertain Commitments

Please note that the term *contingent liability* refers to two entirely different things in IFRS and ASPE.

International Financial Reporting Standards: Contingencies and Uncertain Commitments

A *contingent liability* is an existing obligation or possible obligation that is not recognized in the financial statements as it is a *possible obligation*, and a possible obligation does not meet the definition of a liability under IFRS.¹⁴ Outcomes thought to have a high possibility of occurring are recognized as liabilities on the SFP. In contrast, outcomes believed to have less than a high possibility of occurring are recognized as *provisions* when these two conditions are satisfied:

1. It is *probable* (i.e., greater than 50%) that a *present obligation* exists, and
2. The amount of the provision can be *measured reliably*.

IAS 37 requires the *best estimate* and the *expected value method* to be used by preparers to measure the value of a provision. The *expected value method* requires preparers to assign probabilities (weights) to the possible outcomes, and then, to determine a specific amount by taking the summation of the weighted outcomes. Neither the best estimate nor the value derived from the expected value method is necessarily used to measure a provision though. Rather the best estimate and the expected value method are used by preparers to establish the “boundary points” for determining the value of the provision. Ultimately professional judgement is used to make a final determination. Disclosures must be provided in the notes accompanying the financial statements on how the value of the provision is determined.¹⁵

¹² In its application of the expense approach, the company records all cash proceeds as sales revenue at the point of sale (year #1), and this treatment can be juxtaposed with the revenue approach, whereby a portion of the cash proceeds collected by the company is recognized as unearned revenue at the point of sale.

¹³ The company makes the same entry in subsequent years when customers redeem coupons for rewards.

¹⁴ The existence of a possible obligation may or may not be confirmed by uncertain future events.

¹⁵ Additional disclosure requirements are elaborated on page 838 of the textbook.

Accounting Standards for Private Entities: Contingencies and Uncertain Commitments

Application of ASPE requires contingent liabilities to be recognized on the SFP. Section 3290 of the CPA handbooks states a contingent liability is measured and recognized on the SFP when these two conditions¹⁶ are satisfied:

1. It is *likely* (i.e., high probability) that a future event will confirm that an asset has been impaired or a liability has been incurred at the date of the financial statements,
2. The magnitude of the loss can be *reasonably estimated*.¹⁷

Often there is a wide range of possible amounts that can be recognized as the value of a particular contingent liability. If a specific amount within the range is a better estimate than the other ones, then the best estimate is recognized as the value of the contingent liability. If no particular amount in the range is determined to be the best estimate, then the lowest value in the range is used to determine the contingent liability's value. All other amounts that fall in the range are disclosed in the notes accompanying the financial statements though.

Financial Guarantees

A *financial guarantee* is a legally binding undertaking to stand in the place of a party for whom a guarantee is given to discharge their obligation in the event the original party fails to do so.¹⁸ When Canadian homeowners, for instance, secure a high-ratio mortgage (i.e., a situation, whereby the borrower only makes a down payment between 5% and 20% of the value of the property), they are required to purchase mortgage default insurance from either Canada Mortgage and Housing Corporation, Genworth Financial Canada or Canada Guaranty. These companies provide insurance plans to cover lenders in the event that holders of high-ratio mortgages default on their mortgage(s).

ASPE mandates financial guarantees to be accounted for in the same manner contingencies are handled. (Please refer to the above notes.) IFRS, on the other hand, mandates any financial guarantee to be initially recognized at fair value. [Please refer to IFRS 13 ("Fair Value Measurement") for more specific guidance on how to do this.] After a financial guarantee is recognized at fair value, then it is measured at the higher of (1) the best estimate available on the date of financial statements concerning the projected payment needed to settle the obligation¹⁹, and (2) any unamortized premium received as a fee for the guarantee (i.e., unearned revenue).

Both accounting frameworks requires certain, specific disclosures to be includes in the notes accompanying the financial statements. Details on these disclosure requirements are expanded in both the textbook and the CPA Handbook.

¹⁶ If a potential liability is not recognized on the SFP for the reason that it does not satisfy either of the two conditions, then details on the potential liability are disclosed in the notes accompanying the financial statements, such as details on: (1) the nature of the potential loss exposure, (2) the estimated amount(s) of the loss exposure, and (3) the likelihood the loss will manifest.

¹⁷ That is, it is possible to make a reasonable and reliable estimate on the value of the value of the liability.

¹⁸ Direct excerpt from page 1600 of the textbook.

¹⁹ In the case there is a range of estimates available, then the expected value of the possible outcomes is determined.