PSAB
Public Sector
Accounting Board

PUBLIC SECTOR ACCOUNTING DISCUSSION GROUP

Report on the Public Meeting

November 17, 2017

The Public Sector Accounting (PSA) Discussion Group is a discussion forum only. The Group's purpose is to support the Public Sector Accounting Board (PSAB) by enabling discussion in a public venue of issues arising from the application of the CPA Canada Public Sector Accounting Handbook (PSA Handbook), as well as emerging issues and issues on which PSAB requests advice. The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of PSAB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of PSAB and is based on discussions during the Group's meeting.

Comments made in relation to the application of the PSA Handbook do not purport to be conclusions about acceptable or unacceptable application of the PSA Handbook. Only PSAB can make such a determination.

ITEMS PRESENTED AND DISCUSSED

Compliance-Type Audit Reports: Implications for Public Sector GAAP

The submission discussed the implications of compliance-type audit reports (Canadian Audit Standards - (CASs) 210 and 700) with emphasis-of-matter paragraphs on public sector general purpose financial statements prepared in accordance with an unacceptable framework, for encouraging adherence to public sector generally accepted accounting principles (GAAP) in Canada. In particular, the potential for increased legislated accounting that is not GAAP was a concern. Another issue was the public's ability to understand the nuances and meaning of different types of audit reports, as well as the nature, implications and extent of any differences from GAAP.

PSAB requested the Group discuss this issue in its public forum given an increased use of compliance-type audit reports on general purpose financial statements prepared using legislated accounting that is inconsistent with GAAP since CASs 210 and 700 were issued. There is a perception that GAAP is being undermined and that these audit reports might not be sufficiently flagging GAAP departures. The Group considered two views: The first asserts that the emphasis-of-matter paragraph in a compliance-type audit report that references a narrative in the notes about departures from GAAP is sufficient. The second asserts that it is not; qualified fair presentation, not in accordance with GAAP audit reports on general purpose financial statements are preferred.

The discussion acknowledged that sovereign governments have the power and right to legislate accounting requirements. And such requirements are established through a public, democratic legislative process that should be respected. While respecting the legislative process, it was noted that if sovereign governments choose to legislate accounting, the general purpose financial statements and the audit reports on them must make this choice obvious to the reader.

The discussion referenced the public interest and how best to serve it, indicating that variability in audit opinions for general purpose financial statements may create confusion that the public should not have to resolve. The public's responsibility to look beyond the audit report to understand financial statements was nevertheless acknowledged.

The Group acknowledged that quantifying differences from GAAP in any audit report on general purpose financial statements not prepared in accordance with GAAP would assist public understanding and perhaps prompt discussion. Alternatively, the Public Sector Accounting (PSA) Handbook could require disclosure of differences from GAAP in financial statements that depart from GAAP. There was a general feeling that Canada has comprehensive public sector GAAP and so general purpose financial statements of governments and other public sector entities should only be prepared in accordance with GAAP. Given the public sector share of the economy and the size of some governments and their entities, a comparison was drawn with banks, noting that if they set their own accounting principles, it would be seen as unacceptable.

The Group agreed that both PSAB and the AASB should be updated on the Group's discussion and that collaboration between Boards would help to serve the public interest.

Accounting for Green Infrastructure in Public Sector Financial Statements

The submission asked for clarification on how or whether the PSA Handbook allows green infrastructure to be recognized in public sector financial statements.

Green infrastructure is natural vegetation, vegetative systems, soil in volumes and qualities adequate to sustain vegetation and absorb water, and supportive green technologies that replicate ecosystem functions. Green infrastructure includes designed and engineered elements created to mimic natural functions and processes in the service of human interests. Examples include wetlands, forests, parks, waterways, fields and soil; enhanced structures such as rain gardens, bioswales, stormwater ponds, and urban trees and parks; and engineered structures, including permeable pavement, green roofs, rain barrels, green walls and cisterns.

The Group agreed that PSAB should consider clarifying existing guidance in the PSA Handbook so that it is clear that green infrastructure is eligible for capitalization when costs have been incurred to purchase, develop or better the infrastructure. There should be no comparative advantage to the choice of developing or funding green or traditional engineered (a.k.a., "grey") infrastructure attributed to public sector accounting standards. However, given the issues related to identifying and measuring inherited green infrastructure, it is recommended that PSAB consider the priority of the topic of inherited natural resources for its technical agenda as well as international work on natural and heritage assets.

A second issue asking whether natural structures straddling public and private land can be recognized as an asset in the public sector entity's financial statements was deferred for future discussion.

Section PS 3430: Restructuring Transactions – Recipient Adjustments

Section PS 3430, *Restructuring Transactions,* applies to restructuring transactions occurring in fiscal years beginning on or after April 1, 2018. Section PS 3430 requires a recipient entity in a restructuring transaction in which assets and related responsibilities are received to recognize the assets at the transferor's carrying amount. An issue arises for the recipient when the carrying value of the assets for the transferor is a nominal amount.

In contrast to Section PS 3430, Section PS 3150, *Tangible Capital Assets*, requires contributed capital assets received to be recognized at fair value on receipt. But Section PS 3430 distinguishes restructurings from contributions of assets alone. Section PS 3430 deals only with transfers of an integrated set of assets (and/or liabilities) with related responsibilities that are part of a restructuring transaction.

In the scenario, the transferred assets were immaterial to the transferring government but material to the recipient. The Group discussed the two views in the submission: one reinforcing the requirement to use the transferor's carrying value of a nominal amount; and the other allowing an estimate of carrying value using valuation techniques to comply with Section PS 3150, which was interpreted as allowing fair value. The Group identified a third option for which there was consensus: an estimate should be made of the transferor's carrying value as if the transferor had not been allowed to choose a nominal amount on the basis of the assets being immaterial.

Paragraph PS 3430.38 (c) would allow for adjustments to the recipient's initial recognition amount to reflect recipient circumstances, in this case the fact that the assets were immaterial to the transferor but material to the recipient. The reason for the valuation choice of the transferor is a relevant consideration in determining whether the transferor's nominal amount should be used, or adjustments to the carrying amount for recipient recognition are appropriate. However, such adjustments would not allow a move to fair value but rather an estimate of what the depreciated historical cost of the assets would have been for the transferor if it had not chosen valuation at a nominal amount.

Sections PS 3200, PS 3300 and PS 3390: Social Impact Bonds – Government-Funder Perspective

This discussion was positioned as an initial conversation about an emerging issue – from a government perspective as an initiator of a social impact bond (SIB) arrangement and eventual funder (payor) of the outcomes when or if achieved[1].

The term "bond" is a bit of a misnomer, as these arrangements are generally not issued instruments but rather future contracts on social outcomes. And each of the more than 100 SIB arrangements done globally to date has been distinct. Nevertheless, the initial question was whether an SIB was more in

[1] The scenario used to illustrate the issues for discussion was the 2013 Government of Canada's first SIB initiative, the Essential Skills Social Finance (ESSF) Pilot. A link to a summary of this ESSF pilot project can be found at this link: https://www.collegesinstitutes.ca/file/essential-skills-social-finance-project-fact-sheet/

the nature of debt or equity. SIBs do not perform the way traditional bonds do. The term "bond" generally signals a relatively safe, fixed-income product with principal protection and specified returns. In contrast, SIBs demonstrate certain equity-like features; providing variable returns tied to impact and often not offering principal protection. The Group agreed that these arrangements would give rise to some form of liability for the funding government. An up-front investment by government is not required and no residual interest acquired. Some similarity to public private partnership (P3) arrangements was noted; lessons learned in accounting for P3s can possibly be extrapolated to SIBs.

The second issue was the nature and timing of the obligating event for liability recognition. Progress indicators and an agreed-upon payment schedule may affect this determination. The nature and extent of the risk transfer from government to other parties in an arrangement may be difficult to ascertain. SIB arrangements that extend beyond the term of the government initiating them have the potential to encumber future governments. Alternatively, their derecognition when government changes because the assessment of likely success is re-evaluated could affect the measurement of annual surplus/deficit.

Although there were comments on measurement (e.g., that present valuing of the obligation may be required), there was general consensus that SIB arrangements would give rise to a contingent liability to the government initiator. However, the Group anticipated issues with establishing the likelihood of achieving outcomes to determine timing of contingent liability recognition. Discussions at future meetings are planned.

Public Sector Entities Using IFRS® Standards: Lessee Accounting On Consolidation – IFRS 16 versus PSG-2

International Financial Reporting Standards (IFRS) 16 *Leases,* results in "on balance sheet" accounting for virtually all leases by a lessee. In contrast, Public Sector Guideline 2 (PSG-2), *Leased Tangible Capital Assets*, classifies leases as being either operating (i.e., "off balance sheet") or finance (i.e., "on balance sheet"), based on whether a lease transfers substantially all of the benefits and risks to the lessee. As a result, a public sector entity that uses IFRS Standards, such as an "other government organization," for its own statements would "write off" some of its leases as operating leases when consolidated in the controlling government's financial statements. The submission asked if this is appropriate. It offered alternative views for consideration, including having the government as a whole use IFRS 16 for all leases, or allowing the controlled entity to retain its IFRS 16 approach of recognizing operating leases as liabilities upon consolidation, while the government follows PSG-2.

Reference to *Assets*, paragraph PS 3210.21, was made. The new asset guidance set out in Section PS 3210 states that leases convey rights that meet the definition of an asset for a lessee. So a conclusion could be drawn that a lessee should recognize these "on balance sheet" as assets and corresponding liabilities. The phrase "right to use" in paragraph PS 3210.21 is consistent with the phrase "right of use asset" used in IFRS 16. It could be asserted that Section PS 3210 has a higher level of authority as a primary source of GAAP under the GAAP hierarchy than PSG-2. So paragraph PS 3210.21 should guide the accounting for all leases by lessees in accordance with the PSA Handbook.

Reference was also made to the current International Public Sector Accounting Standards project on leases, which is leveraging and considering IFRS 16.

Nevertheless, the Group agreed that PSG-2 comprises existing public sector GAAP and should be followed, even if its requirements do not reflect international developments in lease accounting. Section PS 3210 was not intended to override the requirements of PSG-2. The Group acknowledged that PSG-2 requires updating. But limited PSAB resources are applied in the context of all Board and stakeholder priorities and revisiting lease accounting may not be addressed in the near future.