

# Public Sector Accounting Discussion Group

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## Report on the Public Meeting

March 15, 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). 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

### Section PS 3410: Authority to Pay and Transfer Receivables

The Group discussed three issues relating to transfer recipient accounting under Section PS 3410, *Government Transfers*. The issues focused on whether the timing of recognition of a transfer receivable must always consider if the transferor's authority to pay is in place.

Issue 1 considered if the transferor's timing of recognition would determine recipient timing. The Group felt that symmetrical accounting by the transferor and recipient would usually occur; but not always. Each party to a transfer would make its own determination of whether authorization is in place. While the public may expect identical timing of recognition, in reality each party may not have the same evidence to support recognition.

Issue 2 asked if a recipient can consider a transfer authorized if the transferor includes a clause that says future payments are "subject to future appropriation". The Group felt that a recipient can look to the substance of the arrangement and other evidence (for example, historical behaviour of payor for similar arrangements, including use of the clause), and make a determination as to whether the asset definition is met. Assessing the likelihood of the clause being used to not pay under an agreement is part of determining the substance of the transaction each year. Sometimes a "subject to future appropriations" clause is more than just a legal acknowledgement of parliamentary authority; there are examples where a government has used it and has cancelled future payments.

Issue 3 considered the case where legislation disallows receivable recognition until authority to pay is in place. The Group expressed discomfort about legislated accounting practices, particularly if the legislation is inconsistent with generally accepted accounting principles (GAAP). Such legislation would

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take away recipient's ability to make its own determination of authorization and the existence of an asset based on holistic evaluation of all evidence available to it.

The Group asked that PSAB consider whether the wording of the standard could be improved to further clarify the authorization requirements for transfer recipients.

### **Section PS 1300: Trusts and Holding Companies – Economic Substance**

The Group discussed two issues examining the economic substance of the relationship of a reporting entity under Section PS 1300, *Government Reporting Entity*; with a trust and with a controlled holding company.

Trusts: Issue 1 considered if all trusts are “trusts under administration” and excluded from a reporting entity under Section PS 1300. The Group felt that the nature of an excluded trust is based on the substance of the relationship of the trust with the reporting entity. The test is two part:

- is the entity a trust (legal); and
- is it “under administration” as defined in Section PS 1300.

The key is that an entity that is “under administration” is not controlled as defined in Section PS 1300; the two types of relationship are mutually exclusive.

Holding companies: Issue 2 reconsidered the question of holding companies in relation to municipal hydro operations<sup>1</sup> and asked if all holding companies have economic substance for accounting purposes. The scenario noted that there are separate hydro distribution and generation government business enterprises (GBEs). Distribution is separate because it is rate regulated. Some governments hold distribution and generation entities directly. Others have a holding company between government and those entities.

The Group felt that there is no single answer. The substance of a holding company will vary. Some have no economic substance (for example, passive, perfunctory Board and Board meetings, no business activities or purpose, etc.). Others will have economic substance and the nature of the holding company will have to be evaluated. It can be argued that a holding company is a business if it operates like a business (for example, has a Board of Directors that participates in business of the entity, has day to day activities, etc.), and the holding company Board makes capital decisions (for example, whether to provide a dividend to government or reinvest in the hydro business, and the holding company is financially self-sustaining from hydro rates, etc.).

Certain members indicated that in the hydro example the holding company could be a GBE because it holds investments in entities that together comprise a business. The businesses of the holding company are significantly interrelated. The only mandate of the holding company is to run a hydro business housed in two entities for legal and regulatory reasons, including making dividend or reinvestment of capital decisions. In such cases, a holding company hydro GBE in its entirety -- on a consolidated International Financial Reporting Standards (IFRSs) basis -- would be included in government financial statements by the modified equity method.

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<sup>1</sup> See Group discussion of whether a holding company can be a GBE on November 18, 2016.

Two further possible examples were discussed:

- The holding company is an other government organization that elects to use IFRSs because it holds investments in separate unrelated businesses that are GBEs or not GBEs or a mix. The key is that the investments held by the holding company do not together form one business. When the holding company is consolidated in government financial statements, its investment entities would be accounted for by the government according to their individual substance as described in the Introduction.
- The holding company is an other government organization that uses the standards in the PSA Handbook because it holds investments in entities that have a mix of business and social policy responsibilities. When the holding company is consolidated in government financial statements, its investment entities will be accounted for by the government according to their individual substance as described in the Introduction.

### **Section PS 2600: Foreign Currency Debt – Rates and Hedges**

The Group considered only one of the three issues in the submission, deferring the hedging issues to a future meeting. The rate question related to departmental financial statements and asked what exchange rate, the initial rate on the debt or the current rate, a department should use to translate the borrowing and on-lending to a government organization of an amount denominated in a foreign currency. The department applies Section PS 2600, *Foreign Currency Translation*.

Three transactions comprised the scenario:

- A government department issues debt externally in a foreign currency.
- The amount borrowed by the department is then loaned to a government organization under the exact same terms and conditions, creating a loan receivable from the government organization to the department, which directly offsets the department's debt payable.
- The recipient organization enters into a derivative contract to hedge its currency exposure from its payable to the department.

The Group did not reach a clear consensus. Clarification of the mechanics of the borrowing and on-lending took some time. Certain members acknowledged that a broad interpretation of Section PS 2600 might allow a conclusion that the borrowing and on-lending comprise a synthetic instrument that emulates a comparable Canadian dollar debt and receivable because of the zero currency exposure of the arrangement and the expectation that related currency gains and losses would never be realized. Members also acknowledged the cost-benefit considerations of deferring and amortizing (and putting in a system to do so) gains and losses that may never be realized. Nevertheless, there was some discomfort with not recognizing gains and losses on such a foreign currency debt and related receivable. More up to date and detailed guidance for offsetting financial assets and financial liabilities exists in Section PS 3450, *Financial Instruments*. The GAAP hierarchy would require consideration of such guidance given that Section PS 2600 does not directly address the issue in the submission.