PUBLIC SECTOR ACCOUNTING DISCUSSION GROUP

Report on the Public Meeting
November 15, 2019

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 Group discussions do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the PSAB staff 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

Introduction, Sections PS 1300 and PS 3070; Changing Financial Reporting Frameworks: When is a Government Business Enterprise (GBE) No Longer a GBE?

The Group was asked to discuss three issues.

Issue 1 asked when a public sector entity would no longer meet the definition of a GBE. Discussion focused mainly on the requirement in the GBE definition[1] that the entity be financially self-sustainable from revenue from sources outside of the government reporting entity. If the GBE does not consistently or continuously meet these criteria, it may trigger a reclassification to another type of government organization.

The Group discussed factors, and changes and trends in those factors, to consider when evaluating if a GBE continues to be financially self-sustainable from revenue from outside of the government reporting entity. These were based on the guidance in GOVERNMENT REPORTING ENTITY, paragraphs PS 1300.28-.31. A table outlining them in the submission[2] was divided into:

- financial factors (including deficits and debt);
- revenues from government (assistance and sales);

[1] Introduction to Public Sector Accounting Standards, paragraphs.06 (c) and (d).

[2] The submission to the PSA DG included this table as did the observer notes. The Group has recommended that PSAB consider publishing it as non-authoritative guidance.

- autonomous pricing power; and
- future projections.

Group members suggested further considerations.

- Several noted a change in a GBE's financial self-sustainability would have to be considered structural, or at least other than temporary, before reclassification would be appropriate. Ascertaining this would be difficult and is a matter of professional judgment. Flipflopping between classification as a GBE and another type of government organization would not provide appropriate accountability nor would it be a good use of public resources.
- The controlling government's intentions and actions when the entity's financial self-sustainability is in doubt would need to be considered in evaluating if classification as a GBE remains appropriate.
- Group members' additional comments included:
  - GBEs are deliberately set up to run a business; the GBE definition is a significant threshold to meet.
  - A controlling government should apply the factors and changes in factors consistently when evaluating any GBE for financial self-sustainability. However, they are not a checklist.
  - Periodic evaluation of an entity's classification as a GBE is important. Some will clearly be GBEs, others will no longer qualify, and a few are in a grey area in between.
  - A GBE is part of government. It benefits from being part of that collective, even if its relationship with government is more independent than other government organizations. An increase in government intervention in a GBE may indicate a change in its financial self-sustainability. Examples of this include if the government is:
    - investing further capital in the entity;
    - interfering with operations or pricing;
    - restricting the market for the GBE's goods and services;
    - limiting the GBE's ability to borrow;
    - putting the GBE at a competitive disadvantage with its private sector peers; or
    - overriding the GBE's board.
- Comparing to private sector peers may help evaluate a GBE's finances. An example of this would be a one-time government assistance to a GBE in response to events or incidents for which a private sector entity would be insured. Such assistance may occur because the government self-insures; it would not comprise government financial intervention in the GBE.
- When evaluating a GBE's financial self-sustainability, more weight should be given to the entity's past financial position and results than to future projections. Projections inherently present

uncertainties. Whether losses are recurring or provide evidence of a systemic problem would be considered.

- Whether the controlling government has changed the entity's structure or operations would be a factor. Examples would be if a social program has been downloaded to the GBE or if an unsustainable pricing structure has been mandated for a service. To mitigate its impact on GBE finances, a government downloading responsibility for a social program to a GBE may reduce the dividend required from the GBE.
- Government assistance to a GBE may be in-kind assistance as well as transfers and purchases of goods and services. An example would be providing operational expertise necessary to the GBE's business. Further, a government may borrow on behalf of a GBE or equity invest in a GBE.
- Consideration should be given to a GBE's cash flows in addition to its surpluses and deficits. Is it meeting its cash requirements, and can the controlling government's expectations of dividends be met?

The Group recommended that PSAB consider ways to make the table used as the basis for Group discussion, supplemented by Group input, accessible to stakeholders, perhaps by publishing non-authoritative guidance.

Issue 2 asked whether an entity established with the intent to be a GBE but not yet financially self-sustainable from revenue from outside the government reporting entity should be initially classified as an "other government organization" (OGO) until it is financially self-sustainable. Three views were provided:

- View A argued for initial classification as an OGO.
- View B argued that a start-up could be a GBE if the start-up phase is limited to a short period of time based on realistic and specific plans to be financially self-sustainable.
- View C argued for a distinction between the controlling government as a source of capital versus a source of operating funds in determining the financial self-sustainability of a start-up GBE.

The Group members' comments included the following:

- A government generally structures an entity as a GBE because its projections support its belief that the entity has strong potential to be financially self-sustainable from revenue from outside of the government reporting entity. It is a mid- to long-term policy choice, not a short-term decision based on how such an entity would be included in government financial statements. Such an entity should be given a chance and time to succeed or fail; then the government would reassess its classification.
- Switching classifications from OGO to GBE (or vice versa) would be a financial and administrative burden.

- A private sector profit-oriented entity would not need to use a different set of generally accepted accounting principles (GAAP) in its start-up phase. Its aim is to become profitable. A GBE has the same objective.
- One Group member noted that many Indigenous GBEs should probably start out being classified as OGOs because:
  - they tend to be small;
  - they rely significantly on the controlling Indigenous government;
  - they may initially receive significant funding from other governments; and
  - the controlling Indigenous government usually forms the entity's initial board and is more involved in its operations at inception.
- A few Group members felt that View C, which distinguishes between capital (i.e., investment) and operating (i.e., assistance) infusions from the controlling government was relevant to assessing the financial self-sustainability of a start-up GBE.

The Group ultimately concluded that a combination of Views B and C was appropriate. Most Group members felt that a start-up entity intended to be a GBE could be classified as a GBE even if it is not yet financially self-sustainable from revenue from outside of the government reporting entity. However, the start-up period after which the entity would be expected to be financially self-sustainable should not be too long and the capital/operating infusion distinction should be made.

Issue 3 asked if additional guidance could be provided to an OGO in determining when it should use the standards for publicly accountable enterprises in Part I of the CPA Canada Handbook – Accounting (which comprises IFRS® Standards) instead of Public Sector Accounting Standards (PSAS) as its financial reporting framework. The Group agreed that the existing guidance in the Introduction paragraphs.19-.20 is sufficient. It agreed that this guidance requires a determination to be made after applying criteria and that using IFRS Standards or PSAS is not a free choice. PSAS is the default GAAP unless the nature, circumstances and users of the entity would, after applying the criteria, be better served by IFRS Standards.

The Final Report of the Expert Panel on Sustainable Finance

The Group received an overview of the final report's recommendations that have clear implications for standard setting. In particular, the submitter focused on the impacts of climate change on a public sector entity's assets, liabilities, revenues and expenses. Examples of these included:

- asset impairments;
- changes in assets useful lives;
- new contingent liabilities;
- disaster-relief expenses;

- changes in revenue streams; and
- risk disclosure.

The Group was asked to discuss possible strategic options for PSAB in responding to climate change issues as a public sector standard setter. Three options were explored.

Option A – Status quo

- Continue to watch as an emerging issue. While climate change is an important issue, existing guidance properly addresses its impact on a public sector entity's financial statements.

Option B – Initiate one or more projects to develop guidance and support voluntary disclosure

- Initiate one or more projects to provide training, guidance and support to CPAs in the public sector.
- Monitor and report on voluntary disclosure efforts in the public sector.
- Consider issuing non-authoritative guidance.

Option C – Integrate climate change into existing PSAB standards.

- Initiate a review of all existing standards and update for climate change impacts.
- Require all current projects to consider implications of climate change in proposals.
- Integrate TCFD[3] disclosures (international, private sector company focused) into PSAB standards and/or FSD&A[4] as appropriate.

The Group asked what work is being done internationally. It received a summary of what several international groups[5] and standard setters are doing. CPA Canada has also committed to look at sustainability. It is felt that Canada should work collaboratively with other countries and groups on creating a common framework on this issue, given its immediacy and the various efforts already underway. Like PSAB, the Canadian Accounting Standards Board (AcSB) is also considering sustainability as one of its potential strategies in its next strategic plan.

One Group member said that Indigenous governments are vulnerable to the impacts of climate change, facing medium to high risks depending on their location. They are responsible for a wider range of services than most other governments. Their responsibilities include many usually handled by municipal and provincial governments, including health, education, services to property, housing and disaster relief.

---

[3] Task Force on Climate-related Financial Disclosures https://www.fsb-tcfd.org/

[4] PSAB Statement of Recommended Practice 1, *Financial Statement Discussion and Analysis*

[5] For example, the Sustainability Standards Board, the Global Reporting Initiative and Integrated Reporting.

One Group member expressed concern that benchmarking to isolate the impacts of climate change for financial reporting purposes is a necessary first step. What is considered extreme might vary according to where an individual lives.

The Group agreed that PSAB should pursue Options B and C, starting with B to respond more quickly to stakeholders' needs. Setting new standards through the traditional due process may be too slow for this issue. Adding consideration of climate change issues/risks to existing projects would be responsive. Leveraging the others' work would be critical to success, given timing and limited resources.

The Group also recommended that PSAB review existing standards to understand if they can be interpreted as open to consideration of climate change issues, especially disclosures. An example would be disclosure of climate change risks, or climate change could be an additional factor in assessing asset impairment. Considering if the contingent liability guidance is sufficient is another example. Unaudited disclosures might be a start, given measurement issues. Group members considered where best to report climate-related issues and disclosures to allow a public sector entity to tell its story about the implications of climate change on its jurisdiction's finances. This could be in the financial statements themselves or in the FSD&A.

After this work is done, some Group members suggested PSAB should publish guidance, perhaps non-authoritative, to indicate where climate change issues could fit within existing GAAP. A next step could then be a review to identify any gaps in the standards necessary to address the financial reporting implications of climate change.

Sections PS 3400 and PS 3510: User Fees versus Taxes

The Group was asked to evaluate four scenarios in which a charge had been levied then discuss whether the charge is more in substance a tax to which Section PS 3510, *Tax Revenue*, would apply, or a user fee, to which Section PS 3400, *Revenue*, would apply.

The Group was given two tables of factors to consider in evaluating whether each of the four charges in the scenarios is more in the nature of a tax or a user fee. Most factors were derived from existing case law, others from municipal user-fee design guidelines. As these tables go beyond existing accounting literature and incorporate case law, some Group members said that they should not be lost after the Group discussion. PSAB should consider publishing some form of non-authoritative guidance. Such guidance could use a visual to illustrate characteristics that would clearly show which levy is a tax, which is a user fee, and which are less clear.

The Group concluded that, in all four cases in the submission, the charge was more in the nature of a tax.

Further, the Group felt that the discussion had accomplished the following:

- It discussed aspects of the new standard REVENUE, Section PS 3400, which has an effective date of April 1, 2022, in a public forum, raising awareness of the new standard.

- It made it clear that the new revenue standard distinguishes between transactions with performance obligations and those without. There may be timing of recognition implications of this distinction.

- It highlighted that for some charges, whether accounted for in accordance with Section PS 3400 or Section PS 3510, revenue recognition might occur in the same accounting period. It is the financial statement presentation of the revenue source that would differ (i.e., as tax revenue or user-fee revenue).

- It noted that it is possible that the timing of recognition of a charge that has a performance obligation could be different than that for a tax. If, for example, a charge was levied at the end of one year for a future year or years, revenue recognition would occur as the performance obligation was satisfied in the new year or over the future years.

One Group member noted that the distinction between a user fee and a tax is an important one for Indigenous governments. They need to have federal legislation to impose a tax. To date, user fees are levied more often than taxes. Indigenous governments with self-governing agreements have powers to tax.

PSAB's Government Not-for-Profit Consultation Paper

The Group was asked to weigh in on two questions asked of stakeholders in the PSAB's May 2019 "Government Not-For-Profit Consultation Paper:

1. What are the advantages and disadvantages of governments and government not-for-profit organizations (GNFPOs) using the same accounting and financial reporting standards?

2. What are the advantages and disadvantages of all GNFPOs following the same accounting and financial reporting standards?

The Group discussed both questions together.

Some Group members said that GNFPOs' decision on which GAAP to use is driven by the needs of GNFPO financial statements users. One Group member noted if the GNFPO statement users are different from those of government, perhaps the GAAP used should be different too. Others said that the users are the same for both. The public sees the SUCH[6] sector as part of government and government is a primary user of GNFPO statements. Still another member mentioned academic research[7] that user needs and the stated link to accounting standard setting may be a false construct, especially the assertion that financial statement information should be chosen to assist in users' decision making.

---

[6] Schools, universities, colleges and hospitals.

[7] Joni J. Young, "Making up Users," *Accounting Organizations and Society*, 31 (2006) 579–600 doi:10.1016/j.aos.2005.12.005 http://elsevierscitech.com/lmfile/otherformat/1359_Joni_Young.pdf.

The Group briefly debated the information value of the net debt indicator for GNFPOs; some noting its value. One Group member acknowledged that all GNFPO financial statements should be comparable; especially organizations of the same type, such as universities. However, if PSAB were to mandate by type of entity what is in or out of the government reporting entity, rather than associating entities with a government through control, then the link to what the government is accountable to the public for is lost. Another noted that not all government financial statements across Canada are comparable and having such an expectation of comparability for GNFPOs may be unrealistic.

One Group member expressed the opinion that:

- all publicly funded entities should use the same GAAP;
- different GAAPs affect accountability and cause confusion;
- choices of different GAAPs may allow for bottom-line management; and
- only substantive differences should prompt consideration of different accounting or reporting for a particular type of public sector entity.

The Group was encouraged by PSAB's progress in its conceptual framework and reporting model project, indicating that it may address some GNFPOs' concerns. Some Group members noted that the project is part of the solution for GNFPO issues for the Board. In particular, the development of a common reporting model for all public sector entities is important for comparability and accountability purposes. It also provides a benchmark from which the Board can choose to deviate if it identifies substantive and distinct accountabilities that are demanded from different types of entities, such as GNFPOs. One Group member suggested that the Board focus on one SUCH subsector first;for example hospitals. Then PSAB could consider if improvements to address substantive and distinct issues for that subsector can be extrapolated to the rest of the SUCH sector.

Group members felt that simplification of reporting requirements would be helpful, to the extent this is possible. It would make the financial statements easier to explain. And it would ensure that those who cannot demand more information from public sector entities have the information they need for accountability purposes. Using too many different GAAPs does not serve this objective.