

PUBLIC SECTOR ACCOUNTING DISCUSSION GROUP

Report on the Public Meeting November 19, 2018

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

Section PS 3380: Contractual Rights

Section PS 3380, *Contractual Rights*, became effective for periods commencing on or after April 1, 2017. The submission asked the Group to discuss four scenarios and consider if the definition of a contractual right is met and, if so, whether disclosure is required under the standard.

1. **Scenario 1:** A university receives a signed letter stating it is the recipient of scientific research grants from a private sector not-for-profit foundation. The grants, \$10 million a year for five years, will fund specific programs. At the reporting date, the university has not started the work program outlined in the grant application. The university uses the CPA Public Sector Accounting (PSA) Handbook without the PS 4200 series.

The Group agreed that, even given uncertainty about grant receipt, the agreement would meet the definition of a contractual right. The arrangement's relative materiality to the university and whether it is abnormal to the university's financial position or usual business operations would be considered in determining if disclosure is required. Whether individual or aggregated disclosure with other arrangements would provide appropriate transparency would vary depending on the university's circumstances.

2. **Scenario 2:** A university owns a particle accelerator and arranges for a not-for-profit organization (NFPO) to:

- operate and maintain the equipment over a 20-year period;
- provide access to the equipment for university researchers' use;
- manage the use of the particle accelerator by researchers from other Canadian universities that pay an annual user fee; and
- remit all the proceeds from managing the accelerator to the university, net of a fixed quarterly amount (set to cover the NFPO's expected costs).

The NFPO is not a related party of the university.

The Group discussed four aspects of this arrangement:

- The Group felt that a good first step might be to evaluate whether the arrangement contains a lease and if so, then classify it as an operating or capital lease. This would determine the nature of the potential contractual right. The evaluation would not necessarily be required in each case. It is one way of considering the substance over form of the arrangement.
 - If the arrangement is not a lease, the Group agreed that the university would have a contractual right to receive the net proceeds from the NFPO. It would not look through the NFPO and consider the relationship with the end-users.
 - The Group considered the implications if the NFPO is an agent working on the university's behalf. It concluded that the NFPO, as an agent, would likely have no contractual rights with end-users. Public Sector Accounting Standards (PSAS) have limited guidance on principal-agent relationships for the Group to apply in considering whether the agent status should be a key factor.
 - From the NFPO's perspective, if the arrangement is not a lease, the NFPO would have a contractual right to receive cash from the university for management services. The Group felt that, likely, the NFPO would have a contractual right to receive money from the university. However, the existence of such a right and whether its disclosure would be required could only be determined on a case-by-case basis. This would be done after considering the arrangement's materiality and nature in relation to the NFPO's financial position and operations.
3. **Scenario 3:** A hospital undertakes a significant capital construction project. It has a signed funding agreement with its controlling provincial government, confirming that the province will pay for 80 per cent of the project's capital costs. The hospital recognizes a contribution receivable when it incurs eligible costs under the construction contract. The province may terminate the funding at any time with 30 days' notice. In this case, the province would not provide further financing for the construction but may provide additional funds to cover the wind-down costs of the project. The province evaluates that termination of the contract is not probable. The Group debated the weight to give the termination clause, noting that it is included in senior government contracts to recognize supremacy of the legislature. Group members

acknowledged that sometimes arrangements are terminated. However, until termination occurs, contractual right disclosure by the hospital would be appropriate for the 80 per cent of capital costs in its financial statements. Such disclosure would be eliminated when the hospital is consolidated into the provincial government's financial statements. A thorough disclosure of the whole project would be appropriate to put the funding in context and provide transparency to users.

4. **Scenario 4:** Hospital A enters into a five-year agreement with Hospital B to share operating costs of a specialized operating theatre. Hospital A incurs all costs first and is reimbursed in part by Hospital B. The Group discussed the impact of each of the following factors (considered independently or each other) on the determination of whether there is a contractual right for Hospital A.
- Hospital B can terminate the contract at any time without penalty.
 - Hospital B can terminate the contract for a financial penalty (below the proportionate share of the cost-sharing agreement otherwise payable).
 - The contract contains no termination provision. Hospital B pays 20 per cent of costs and has a right to 20 per cent of available capacity of the specialized operating theatre. Hospital B pays 20 per cent of the costs regardless of its use of the theatre.
 - The contract contains no termination provision. Hospital B pays an amount in proportion to its use of the specialized operating theatre. There are no minimum-usage clauses, although Hospital B is limited to not more than 50 per cent of the available capacity.
 - Hospitals A and B conclude that the arrangement is a government partnership. They share control over the specialized operating theatre (an asset under shared control as per GOVERNMENT PARTNERSHIPS, paragraph PS 3060.26). Can Hospital A have a contractual right with its partner?

The Group found that the contract may become less enforceable depending on the ease of termination. This would affect the disclosure decision.

The Group noted that PSAB may want to consider clarifying in the contractual right definition; the requirement that a contractual right will result in both an asset and revenue in the future, to include the possibility of a reduction in expenses. Members debated whether a contract involving reimbursement or a reduction of expenses would meet the contractual right definition. Substance over form would be a consideration. PSAB considered expanding the definition in this way when finalizing the standard. This situation would lead to an overall increase in economic resources to the entity and, so, be consistent with the intended scope of the standard. However, PSAB could not think of any common examples to support the change, and so concluded that there was not much value in expanding the definition and such expansion could result in confusion in application.

The Group concluded that the scenario implies a spectrum. There is a point after which the activities and access contemplated in the arrangement resemble a government partnership more than a contractual right under Section PS 3380. A government partnership between the two hospitals would be included in their financial statements on a proportionate consolidation basis. This treatment would be a form of netting of the inflows and outflows from the arrangement.

Section PS 3070: Accounting for Indigenous Government Business Enterprises

The Group discussed its first direct submission on behalf of Indigenous governments, which raised five issues relating to the accounting for Indigenous government business enterprises (GBEs). The presentation was made by Mike McIntyre, Chief Financial Officer of Membertou First Nation in Nova Scotia; and Scott Munro, Director of Standards and Certification for the First Nations Financial Management Board (FMB).

Mr. McIntyre and Mr. Munro provided some context for the issues, emphasizing the importance and magnitude of own-source revenue from GBEs to the finances and self-determination of Indigenous communities. They noted that accounting for Indigenous GBEs can affect the FMB's certification work and the ratios funders use to evaluate funding eligibility. The presenters highlighted the range of Indigenous GBEs, from small to large. They noted that many Indigenous GBEs are very small. Bigger, more successful GBEs may contribute to their government's own-source revenue, and thus support its capital market access. One GAAP for GBEs may not meet everyone's needs. The presenters clarified that some Indigenous governments levy taxes to supplement funding for programs, as they often receive insufficient transfers. However, the land base for taxation is limited. For this reason, Indigenous governments are exploring all possible alternative sources of revenue. The demographics of Indigenous communities with the large number of young people, the higher graduation rates, and the need for employment are driving this desire to grow own-source revenue.

The presenters talked about the Indigenous governments' distinct financial reporting needs, asking that PSAB consider them when setting standards. One example is the close relationship Indigenous GBEs have with their controlling government, especially the Chief and Council. Indigenous GBEs are like family businesses because the community depends on own-source revenue from its businesses for its financial wellbeing. This is one point for the Board to consider if it re-evaluates what GAAP Indigenous GBEs should use for their own financial statements.

General-purpose financial statements are prepared for accountability to Indigenous community members. Indigenous governments prepare many other reports related to funding received from other governments. The presenters noted that some Indigenous governments spend 80 per cent of their time on reporting requirements for the 20 per cent of their revenue that comes from other governments. A member asked whether the reporting burden on Indigenous governments in relation to such funding could be eased by ensuring that financial statements provide some of the information required by funders. Or, whether PSAB could work with Indigenous governments and funders to reduce overlap and redundancy in reporting.

Many Group members commented on how little they knew about Indigenous government finances and financial reporting and welcomed the opportunity to learn and discuss the issues. One theme throughout the discussion was a struggle to balance adherence to the PSAS technical requirements with a desire to ensure that the standards meet the needs of the users of Indigenous government financial statements – its community members. The needs of other users, such as funders and investors, and the extent to which their reporting needs would affect Indigenous government financial statements, were also considered.

Issue 1

Issue 1 asked whether controlled Indigenous GBEs can be excluded from the financial statements of the controlling Indigenous government. This issue was raised because some Indigenous governments perceive that consolidation of successful Indigenous GBEs has the potential to negatively affect the federal funding received by a controlling Indigenous government. Many Indigenous governments consider own-source revenue private information not meant to be disclosed or shared with anyone other than their community members.

Group members discussed the two views. One member wondered if there is another option that would better honour Indigenous culture and communications practices. Group members felt that GBEs could not be excluded from Indigenous government financial statements. Members of Indigenous communities need a complete, consolidated picture of their government's finances. Including GBEs is especially important given how materially they affect the finances of many Indigenous communities. A member asked whether GBEs are controlled entities or just part of the Indigenous government; that is, whether Indigenous GBEs are less distinct from the government than GBEs of other governments.

Group members concluded that general-purpose financial statements are prepared for accountability to community members. Funders' needs should not skew the requirements and affect that accountability. Some Group members noted the distinction between reporting for funding and reporting for accountability to community members. A member suggested that perhaps special-purpose financial statements for funders might be appropriate, but it would add unnecessary cost and effort to Indigenous governments with little capacity. Another member asked whether consolidation of Indigenous GBEs, rather than modified equity accounting, would better reflect the integration of these entities in Indigenous communities. Along similar lines, another member asked if some Indigenous GBEs meet the GBE definition or should just be classified as "other government organizations" (OGOs).

Issue 2

Issue 2 asked which set of GAAP should be used by Indigenous GBEs for their own financial statements. The PSAS require that they use IFRS[®] Standards. However, these standards are burdensome and costly for most Indigenous GBEs and do not reflect their small size or close relationship to the Indigenous government and community. They also do not take into account Indigenous community members' financial literacy, which may affect the accountability value of the resulting financial statements to the members. Most Indigenous GBEs use the Accounting Standards for Private Enterprises (ASPE) issued by the Canadian Accounting Standards Board instead of IFRS

Standards and do not receive qualified audit opinions. There is an argument, however, that Indigenous governments involved in capital markets might need to use IFRS Standards for their GBEs to satisfy investors.

Group members noted the current PSAS requirement for GBEs to apply IFRS Standards when preparing their financial statements. However, the Group acknowledged that PSAB did not consult Indigenous governments when it referred GBEs to IFRS Standards. At the time Indigenous governments were not applying PSAS. Also, ASPE was just being created when the Board decided to require GBEs to use IFRS Standards. Group members suggested the Board could develop criteria for when an Indigenous GBE would use IFRS Standards, ASPE, or PSAS. These criteria would be like those in the Introduction to Public Sector Accounting Standards for OGOs to choose between IFRS Standards and PSAS, as appropriate to their circumstances and objectives. This approach would better focus on the needs of the users of the Indigenous GBE and Indigenous government financial statements. The Group encouraged the Board to consider allowing the use of ASPE as an option for the GAAP used by Indigenous GBEs.

Some Group members felt that the expanding the use of differential reporting is a broader question for PSAB, not solely an issue for Indigenous GBEs. As is the issue of using modified equity or consolidation to include GBEs in government financial statements. A Group member noted that a Board decision to explore the question of differential reporting for any group (Indigenous or other level of government or type of public sector entity) would be interesting in the context of the Board's current initiative to explore options for a new international strategy. It could involve convergence, adaption or adoption of IPSAS.

Issue 3

Issue 3 asked whether Indigenous GBEs must break even or have a surplus each year to classify as a GBE. Under PSAS, GBEs are accounted for differently than other entities controlled by an Indigenous government. This is based on the presumption that a GBE differs from other government organizations in its relationship to the government, its objectives, and operations. A GBE is a government's financial asset that is autonomous, financially self-sufficient, and has business-oriented objectives. PSAS allows a different method of accounting (modified equity accounting) for an Indigenous government's "for-profit" commercial activities so they can be reported and classified separately from the government's service-delivery operations. This is valuable to financial statement users because it allows for different analysis of these two different activities.

Some Indigenous GBEs are accounted for under the modified equity method when the GBEs have a long history of losses and injections of capital or interest-free loans with no maturity given by the Indigenous government. Some Indigenous businesses that are reported as GBEs also serve a social purpose, such as employment and training, which may outweigh the overall profit motive for some time.

Questions have arisen about the need to meet the financial self-sufficiency criterion in the GBE definition. In particular, whether the nature of these ventures as separate businesses, different from the service-delivery operations of the government, is enough to justify including such businesses in the

Indigenous government's financial statements using modified equity. Audit opinions vary regarding GBEs that do not meet the financial self-sufficiency criterion.

Group members suggested that PSAB could further clarify when an entity no longer meets the GBE definition. For example, the Board could provide guidance on when a GBE's operations would be permanently impaired and the definition is no longer met. The Group felt that the financial self-sufficiency criterion is a key requirement, especially as it allows the Indigenous government's investment in the GBE to be recognized as a financial asset. One Group member summarized that financial self-sufficiency does not mean making a profit. However, it does require the ability to cover costs and meet liabilities. A start-up entity would need a supportable plan for the GBE to achieve financial self-sufficiency from revenue from outside of the Indigenous government reporting entity. Each year its ability to achieve the plan and its reasonableness would have to be evaluated. Some members noted that an entity should not be accounted for as a GBE until it has achieved financial self-sufficiency from revenue from outside of the Indigenous government reporting entity.

Issue 4

Issue 4 asked where the equity pick-up for the income from GBEs should be reported in the Indigenous government's statement of operations. The PSA Handbook is not specific about required presentation. The issue was raised because there is diversity in practice and, depending the presentation, has the potential to affect ratios of an Indigenous government that are essential for capital markets access. Further, if the income from GBEs is included in revenue, then it can mask a federal funding shortfall that is important information for an Indigenous community. One Group member noted that income from GBEs is revenue, but Indigenous governments can be penalized for having own-source revenue in relation to future funding levels, rather than being commended for the effort to support the community through business ventures.

The Group felt that the income from Indigenous GBEs should be included in the surplus/deficit of an Indigenous government. Given the lack of guidance in PSAS about where this income should be presented, the Group suggested that PSAB allow some flexibility. Some members said that the Board should explore options for a subtotal that avoids comingling the GBE income with the results of an Indigenous government's other activities but includes the GBE income in the calculation and statement of surplus/deficit. The presentation should allow the Indigenous government to tell the story of how its GBE income affects its results.

Issue 5

Issue 5 explored the extent of disclosures that should be provided regarding a GBE's financial position and results in Indigenous government financial statements. Such disclosures may impair an Indigenous GBE's competitiveness against providers of similar goods or services. Disclosures can also negatively influence Indigenous governments' negotiations with adjacent municipal governments for services. Indigenous governments feel that these risks for their GBEs are quite different from the those that most other governments face with their GBEs.

The presenters acknowledged that sometimes the information for the required disclosures is not available because of capacity or financial literacy. Some Indigenous GBEs do not prepare their own financial statements. However, Indigenous communities have demanded more information about their government's GBEs, their financial results, and the risks associated with them. Investors need this information too.

The Group felt that both views had merit. The technical requirements to provide disclosure of condensed financial information about its GBEs in a government's financial statement notes are clear under PSAS. However, Group members also felt that disclosures that impair competitiveness would affect Indigenous governments' ability to raise own-source revenue. The Group agreed that the PSA Handbook already provides relief on how much detail is needed in financial statements. For example, in various standards it indicates the following. The level of detail disclosed reflects the highly aggregated nature of financial statements. And, when deciding the level of detail to disclose, the usefulness of the information to readers in assessing the nature and extent of a government's financial position and results would be considered. Further, it may be useful to group similar items together and the level of disclosure should consider the sensitivity of the information to the government's financial position and results.

Sections PS 1000 and PS 1201: Green Infrastructure – Further Issues

The submission built on the November 2017 Group discussion of green infrastructure. The submission raised three further issues:

1. Whether natural structures straddling public and private land can be recognized as an asset in a public sector entity's financial statements.
2. Whether donated green infrastructure can be accounted for as an asset in public sector financial statements, and whether it matters if the donated property was inherited or purchased by the donor.
3. Whether betterments to inherited green infrastructure can be accounted for as an asset when the infrastructure itself is excluded from recognition.

Issue 1

Issue 1 considered the nature of the asset. Three views were provided; View A was that only infrastructure on public land could be recognized. One member strongly advocated that many green infrastructure assets are inseparable networks (TANGIBLE CAPITAL ASSETS, paragraph PS 3150.12) that work together to provide the required functionality/services, regardless of property boundaries. An example would be a group of structures that form a watershed management system, some of which may be on public land and some on private. The member said that it is in the public interest for those making decisions about watershed management not to be guided or impaired by whose land components of the system reside on. Rather, they should make decisions based on what is the right way to manage the water. Accountants and lawyers can document those decisions.

The Group felt that a strict focus solely on land ownership was inappropriate. Many members felt that some version of View B was appropriate, in which green infrastructure that is on private land can be recognized as an asset in a public sector entity's financial statements if the entity has a right to use the infrastructure and underlying land. Easements, rights of way, and leases were noted as examples. Regulation would be insufficient to acquire control of the private land. Expropriation of the private land for public purposes and public benefit was also mentioned.

Other members felt that View C had merit, while acknowledging that current standards likely did not accommodate it. View C held that green infrastructure straddling public and private land can be wholly recognized in a public sector entity's financial statements. The reasoning was that the portions of the structure on public and private land are indivisible and the structure is held for, maintained for, or has been built for public benefit.

The discussion centred primarily on control of the land on which the infrastructure sits or on the right to use such land. Mention was made of the risks associated with a green infrastructure network asset and which party would bear them and the related costs of network or property damage caused by events such a flood. Some members felt that green infrastructure is different than grey infrastructure of comparable functionality. Natural assets exist where they have evolved, while grey infrastructure would normally be built on government-controlled land. For example, water moves through a natural watershed system differently than a through a manufactured system constructed to divert and control the flow. Ultimately, the Group agreed that:

- a version of View B was appropriate, but that the differences between green and grey infrastructure needed to be examined;
- government would need to access the private land to maintain the structure/system; and
- the economic benefit may comprise more than future services, such as climate-change mitigation; benefits the accounting model does not currently address.

Issue 2

Issue 2 raised two questions. First, whether donated green infrastructure can be recognized as an asset in public sector financial statements. The Group agreed that it could, and that the requirements in Section PS 3150 for contributed assets would apply. Second, if this conclusion would change if the green infrastructure donated had been classified as inherited by the donor. The Group expressed mixed views. Some members felt that the transfer of the infrastructure did not change its classification as inherited, so it should not be recognized as an asset by the recipient. Others thought that there is a risk in allowing asset recognition by the recipient in such circumstances. Inherited properties could be transferred back and forth to achieve recognition of inherited natural assets. As Section PS 3150 does not address this nuance, there is no clear answer in the PSA Handbook.

Issue 3

Issue 3 asked whether betterments to inherited green infrastructure can be recognized in public sector financial statements if the inherited green infrastructure itself is excluded from recognition. Group

members felt that these should be recognized as an asset. Even though Section PS 3150 associates a betterment with a recognized asset, it does not explicitly prohibit recognition of the betterment as an asset on its own. In practice, betterments are generally added to the cost of an existing asset. In the scenario discussed, the inherited green infrastructure may actually be an asset; it is just prohibited from recognition by pragmatic exclusions in the conceptual framework. So not recognizing the betterment to inherited green infrastructure as an asset may understate assets. One member compared it to leasehold improvements, indicating that costs incurred to better a rented space can be recognized as assets. Another thought that the component approach to network assets allowed by Sections PS 3150 might allow asset recognition of the betterment if it could be identified as a separate component that is an asset in its own right.

The Chair indicated that there will be more to come relating to green infrastructure and natural capital, and that PSAB should work with external parties to advance its agenda in this area.

Statement of Principles: “A Revised Reporting Model for the Canadian Public Sector”

PSAB asked the Group to discuss the merits of PSAB’s proposal that a revenue or expense of a period could be recognized outside of surplus or deficit of the period it arises, directly in a component of net assets or net liabilities.

In response to some clarifying questions about how PSAB’s proposed reporting model compare to the IPSASB’s reporting model, it was noted that:

- The IPSASB’s model has two categories of financial position that it reports after net assets or net liabilities in its statement of financial position: “other resources” and “other obligations”.
- International Public Sector Accounting Standards (IPSAS) 1, *Presentation of Financial Statements*, was not updated when the IPSASB issued its new conceptual framework. So, PSAB had to consider the requirements of both the framework and IPSAS 1 when ascertaining what the IPSAS reporting model comprises.
- When IPSAS 1 was created, the IPSASB looked at the International Accounting Standards Board (IASB) reporting model and concluded that it would not adopt the concept of “other comprehensive income” (OCI). Instead, the IPSASB decided that when converging with IFRS Standards, in which revenue or expense were recognized in OCI, it would recognize those revenues or expenses directly in net assets/equity. This use of net assets/equity was the result. The IPSASB’s conceptual framework provides the latest thinking on its reporting model.
- Using direct recognition in net assets/equity is like the approach PSAB proposed. The reporting model would allow the Board to consider, for complex or emerging issues, recognizing identified revenue or expense directly in net assets or net liabilities, rather than in surplus/deficit, in the period they arise. In contrast, the IPSASB model does not disallow recognition directly in net assets but does not open the door to such recognition.

Further responses to clarifying questions indicated that:

- Under PSAB's proposed model, the portion of the equity pick-up of a GBE related to the GBE's OCI would be recognized in the controlling government's accumulated remeasurements component of net assets or net liabilities.
- The label "accumulated other" is a placeholder until PSAB uses this component and the nature of the transactions recognized in it can inform a more descriptive label.
- Items to be excluded from surplus/deficit would only be those designated by PSAB. No extrapolations from those items to others deemed to be similar would be allowed. Preparers could not choose direct recognition in net assets or net liabilities for items not designated by PSAB.

The Group provided feedback on the proposals in the Statement of Principles regarding the components of net assets (or net liabilities) approach. Comments included:

- One Group member noted that many members of the Canadian Council of Legislative Auditors (CCOLA) feel that all changes in net assets or net liabilities arising in a period should be recognized in the surplus/deficit of that period. The proposals would seem to provide a way to exclude items from surplus/deficit.
- A few Group members noted that this approach may not provide good accountability to users, who will not understand why items are not in surplus/deficit. The understandability imperative for the public would not be met. Excluded items would likely be complex and the components are not understandable. Local governments already use a breakdown of accumulated surplus/deficit to explain financial position to Council. This new breakdown will confuse that communication.
- If items are to be excluded from surplus/deficit then such exclusion should be rare, extraordinary, and with significant justification. PSAB should develop objective criteria for exclusion that will result in some logical consistency in application. The Board could state up front that using the "accumulated other" category would only be contemplated for certain types of transactions. This would be instead of relying solely on criteria and considering possible use of the component project by project, transaction by transaction.
- There will always be pressure on PSAB to exclude items from surplus/deficit and it may be a slippery slope. A conversation about direct recognition in net assets/net liabilities will be part of every project discussion from now on for the Board. Some items may never go through surplus/deficit under the proposals. This pressure is a risk that the Board must manage. Auditors may also face pressure to allow exclusions from surplus/deficit not designated by PSAB.
- Some Group members felt that the proposals were a necessary compromise to address complex issues and the fact that unrealized remeasurements and other volatile items are not easily budgeted for. Endowment receipts would also be better reflected under the proposed model. The model provides PSAB with the tools to address complex and unique issues in a diverse public sector. One member said that the model considers the circumstances of most public sector entities. Another noted that the proposals would allow for more emphasis on governments' stewardship role.