Public Sector Accounting Discussion Group

Report on the Public Meeting

September 5, 2013

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

The Application of New Handbook Sections

Section PS 3230: The Presentation of Sinking Funds Associated with Government Debt Issued Specifically on Behalf of a Government Business Enterprise

Section PS 3410: Whether a Liability Arises Due to Stipulations Associated with a Government Transfer that Requires the Acquisition and Use of Tangible Capital Assets

Section PS 3410: Indicators of When the Actions and Communications of a Transfer Recipient Evidence Little or No Discretion to Avoid a Liability

Section PS 3410: Whether the Authority to Pay Is a Requirement to Record a Transfer Liability

ITEMS PRESENTED AND DISCUSSED

The Application of New Handbook Sections

The Group's Discussion

Group members discussed their experiences relating to the initial application of new CPA Canada Public Sector Accounting (PSA) Handbook Sections. The Chair asked Group members to focus on standards other than Section PS 3410, *Government Transfers*, as much of the remainder of the meeting would focus on topics associated with the adoption of that standard.

Group members commented on:

- The transition by government organizations to the PSA Handbook – A variety of challenges faced by organizations and the users of their financial statements were identified:
  - The presentation of amended rather than original budget figures was noted as a source of inconsistency. Supporting disclosures were required of entities reporting amended budget figures on the face of their financial statements in one province. Group members indicated PSAB's presentation model, which requires the measure of net financial assets (net debt), was in broad application. One Group member indicated their jurisdiction does not require government organizations to apply PSAB's presentation model. The change in presentation has generated discussion primarily amongst Group members of governing bodies that were not accustomed to it. One Group member suggested experience shows these concerns dissipate once users are more comfortable with the value of reporting net financial assets (debt) as a key indicator. A Group member from another jurisdiction reported on the outreach efforts undertaken to explain the benefits of the presentation approach.
  - Some technical aspects of the transition were discussed. Group members noted the application of Section PS 3255, *Post-Employment Benefits*, required attention due to diversity amongst the sick leave programs offered by public sector entities. Entities transitioning to the PSA Handbook need to thoroughly review these programs to identify benefits that accumulate but do not vest. As well, when Section PS 3250, *Retirement Benefits*, is initially applied, public sector entities need to review key measurement assumptions against requirements in the standard. Some entities adopting Section PS 3450, *Financial Instruments*, have indicated frustration with transition provisions that do not permit items to be retroactively restated to historical cost for which fair value measurement was applied prior to the adopting the PSA Handbook. Another point of frustration is the requirement to derecognize intangibles and works of art when the PSA Handbook is adopted without Sections PS 4200 to PS 4270. Some entities did not anticipate this.
- Section PS 3260, Liability for Contaminated Sites – Several Group members offered comments on efforts to prepare for this standard's adoption. Group members observed the need to carefully evaluate the standard's scope of application and its recognition criteria. The standard applies to sites that are no longer in productive use and contamination arising from an unexpected event such as a natural disaster. Obligations associated with the retirement of an asset in productive use are

outside of the scope of Section PS 3260. PSAB's Asset Retirement Obligations Task Force is currently studying this topic.

- Section PS 3510, Tax Revenue – Implementation has gone smoothly in most instances. Evaluating the likelihood of repaying taxes due to tax appeals has generated discussion in some jurisdictions. These discussions generally focus on the approach to measurement. In the case of larger governments, a significant effort was required to develop and apply models to make estimates. In smaller municipalities, an individual appeal by a large ratepayer may give rise to significant measurement uncertainty. Recognition and measurement of the receivable associated with taxes collected by the Federal government on behalf of the provinces is being discussed in some jurisdictions where it is common place for these amounts to be recorded based on actual receipts.

Section PS 3230: The Presentation of Sinking Funds Associated with Government Debt Issued Specifically on Behalf of a Government Business Enterprise

When a government issues debt specifically on behalf of a government business enterprise (GBE), *Long-term Debt*, paragraph PS 3230.10, requires debt issued on behalf of the GBE and the related receivable from the GBE to be presented on a net basis in the consolidated statement of financial position. Similarly, the interest expense associated with the GBE's liability and the related interest revenue received by the issuer are presented on a net basis. The PSA Handbook does not address the presentation of sinking funds held to retire debt issued by a government on behalf of a GBE.

An illustration was developed to assist in understanding the issue. The relevant facts are as set out below:

- On the last day of Year 1, a province issues debt of $1,000, of this $500 is issued on behalf of a GBE. The debt has been specifically issued by the province on behalf of the GBE and the requirements in paragraphs PS 3410.10-12 are met. The annual rate of interest is 3 per cent.
- To fund the eventual repayment of the issue, a sinking fund is set up. As the sinking fund is under the custody of the province, it is not externally restricted. Sinking fund contributions are initially set at $50 per year, of which the GBE is to remit $25 to the province. The GBE does not have the right to remove investments arising from its contributions to the sinking fund. To fund repayment of the debt issue, the province has a legally enforceable right to apply any balance attributable to the GBE's contributions and reinvested earnings to repay the debt and intends to do so.
- The province invests the sinking fund assets, adding income to the sinking fund balance. Income on the invested assets is $2 in year 2.
- The debt issue is homogenous (i.e., for a trader on the open market, the bonds are the same, irrespective of whether the government or the GBE is funding repayment).

As well, the Group was asked to discuss the presentation implications of a repurchase of a portion of the debt obligation by the sinking fund.

Two presentation alternatives were identified:

Alternative A – Offset the sinking funds attributable to the GBE against the liability to the GBE for its share of the sinking funds. Alternative A is consistent with the presentation approach mandated by Section PS 3230 when debt is issued specifically on behalf of a GBE. Similarly, the statement of cash flows would show any cash flows attributable to the GBE's share of the sinking funds on a net basis. This would be consistent with interest paid and received related to GBE specific debt as required in Section PS 1201, Financial Statement Presentation.

Alternative B – All balances and related cash flows would be presented at their gross amounts.

Based on the facts described above, the Year 2 presentation under each alternative appears below.

Alternative A

Statement of Financial Position

Sinking fund assets (government share)	$26	Debt repayable[1] (government share)	$500

Statement of Cash Flows (indirect method)

Operating activities:

Interest expense[2] (government share)	$(14)

Investing activities:

Contributions to sinking fund (government share)	$(25)

Alternative B

Statement of Financial Position

Sinking fund assets (government + GBE)	$52	Due to GBE	$ 26
		Debt repayable (government share)	$500

Statement of Cash Flows (indirect method)

Operating activities:

Interest expense (government share)	$(14)

Investing activities:

Contributions to sinking fund (government + GBE)	$(50)
Sinking fund contributions received from GBE	$ 25

[1] Gross debt obligation of $1,000 less $500 attributable to the GBE.

[2] Gross interest expense of $28 (being $30 net of sinking fund earnings of $2) less $14 attributable to the GBE.

The Group's Discussion

Group members supported Alternative A as the more logical choice, as the presentation, net of amounts attributable to the GBE, aligns with the presentation of a debt issue when paragraph PS 3230.10 applies. It was noted that *Financial Instruments*, paragraph PS 3450.59, generally prohibits offsetting of a financial asset and a financial liability; however, in this circumstance, the province has the right to apply the sinking fund amount to repay the debt and intends to do so. While alternative B does not offset the sinking fund and amounts contributed by the GBE, Group members felt uncomfortable with the apparent inconsistency of presenting a sinking fund building to $1,000 against a debt obligation presented at a net value of $500.

Group members noted that when a sinking fund acquires a bond accounted for in accordance with paragraph PS 3230.10, the debt issue acquired is not accounted for as an extinguishment. Paragraph PS 3450.45 indicates this and cross-references *Investments in Government Business Enterprises*, paragraphs PS 3070.35-39, which set out the need to account for any gain or loss arising from an inter-organizational bond holding.

Section PS 3410: Whether a Liability Arises Due to Stipulations Associated with a Government Transfer that Requires the Acquisition and Use of Tangible Capital Assets

Section PS 3410, *Government Transfers*, addresses the recipient's accounting of transfers with stipulations. Paragraph PS 3410.23 indicates that in order to record a liability, an obligation arising from a transfer stipulation must meet the definition of a liability in Section PS 3200, *Liabilities*.

The Group discussed two situations that could be encountered when a transferor imposes a stipulation on the recipient of a grant that is intended to fund capital expenditures. The only stipulations associated with the government transfer are those described in each scenario.

Scenario 1 – A government organization receives annual funding to cover its capital expenditures. The government funding is approved through legislation that stipulates the total annual amount granted is for the entity's capital expenditures. Once the funding is authorized, it is disbursed to the entity.

Scenario 2 – In addition to the facts outlined in Scenario 1, the legislation stipulates that capital assets acquired or constructed with the annual funding must be used by the entity in the delivery of its services throughout their useful lives.

The Group's Discussion

The Group discussed each scenario separately. As specific stipulations are absent in Scenario 1, the general view was that no liability is recorded. One Group member dissented from this view, indicating that, pragmatically speaking, a government's funding of the financing of a tangible capital asset creates a valid expectation that a service must be delivered.

The Chair asked if the Group members' views would differ if the recipient had submitted a capital plan in advance of receiving the funding. Views were mixed on whether a liability is recorded on initial recognition. A number of Group members stressed the need to carefully evaluate the agreement between the parties. The agreement was viewed to be important in clarifying considerations such as whether specific capital assets were being funded, whether a right to require return of the funding is present, and to whom the liability is owed. Several Group members asserted funding is rarely returned under this scenario, making any such provision of limited consequence.

The Chair clarified the nature of Scenario 2 with the issue's presenter. Under Scenario 2, the government organization receives a block of funding for capital expenditures. The agreement does not specify specific assets or uses for the funding but does stipulate that capital assets acquired or constructed must be used for service delivery throughout their useful lives. Given these circumstances, a large proportion of the Group members could not identify reasons to record a liability on initial recognition of the grant. A view expressed by some Group members is the services provided are inherent to the organization's mandate.

Some Group members felt it would be possible for a liability to be discharged over the assets service life but acknowledged this could only occur in rare circumstances. Very specific requirements would need to be part of the agreement. However, these Group members were unable to cite any examples. Other Group members concluded such a situation would not be possible.

Section PS 3410: Indicators of When the Actions and Communications of a Transfer Recipient Evidence Little or No Discretion to Avoid a Liability

Upon initial recognition of a government transfer, the recipient assesses whether the transfer gives rise to an obligation that meets the definition of a liability in accordance with Section PS 3200, *Liabilities*. There can be situations where the stipulations of the transfer alone are insufficient to cause the recipient of the transfer to record a liability. Under *Government Transfers*, paragraph PS 3410.20(b), the recipient of a government transfer also considers its own actions and communications.

A multi-part illustration was considered describing actions and communications initiated by the recipient of a transfer subsequent to payment of the transfer. In all cases, the actions and communications take place before the financial statement date.

Part 1:

(a) An organization preparing its financial statements in accordance with the PSA Handbook receives funding from the provincial government to reduce the environmental impact of its farming operations. The organization is not part of the provincial government's reporting entity. The Board of the Directors of the organization has agreed, by board motion, that the funding will be used to improve on-site water treatment at the organization's dairy cattle testing farm.

(b) Facts are as in (a); in addition, the organization announced by press release the allocation from the provincial government and its intentions to use the funding to improve on-site water treatment at the organization's dairy cattle testing farm.

(c) Facts are as in (b); in addition, the organization has entered into contracts for the construction of the water treatment facility (to be completed next year) and ordered all the key equipment required (expected to be received next year).

Part 2:

(a) Due to its specialized knowledge of the dairy cattle industry and the outcomes the organization has achieved at its dairy cattle testing farm, the provincial government provides additional funding. Early in its current fiscal year, the Board of the Directors of the organization has agreed, by board motion, that the additional funding will be used to set up a grant program for eligible farmers to implement similar solutions on their own farms.

(b) Facts are as in (a); in addition, the organization has advertised the additional funding from the provincial government and the proposed grant program on its website and specified which type of equipment would be eligible for the grant.

(c) Facts are as in (b); in addition, the organization has communicated eligibility criteria to each farmer in sufficient detail such that farmers have or may have taken actions in implementing on-site water treatment facilities in the expectation that they will receive the grant.

(d) Prior to the end of the organization's fiscal year, completed grant applications accompanied by supporting evidence of actions in implementing on-site water treatment facilities are in the possession of the organization.

Part 3:

Would the answers change if the actions and communications were directed towards the transferring government alone, rather than the general public?

Part 4:

Finally, what other considerations might apply to Parts 1 and 2 if the organization was part of the provincial government reporting entity?

The Group's Discussion

The Group discussed each Part separately, primarily in relation to reporting implications associated with the application of paragraph PS 3410.20(b).

Part 1:

Generally Group members did not see any of the actions and communications described in Part 1 creating a liability for the transfer recipient. In the case of circumstance (c), several Group members noted the contractual obligation would need to be evaluated for disclosure, but observed this consideration was separate and apart from the transfer transaction. One Group member differed from the others, expressing a view that the press release described in circumstance (b) would result in a loss of discretion sufficient to create a liability.

Part 2:

There is a change in the circumstances in Part 2 because the recipient of the transfer announces a subsequent transfer. There are now two transactions. Group members identified paragraph PS 3410.24 as guiding how aspects of the illustration should be evaluated. When accounting for the incoming transfer from the province, Group members were of the view this would be recognized as revenue. Group members reached this conclusion as direction given to use the funds to reduce the environmental impact of farming operations is more of a general direction than a stipulation. In applying paragraph PS 3410.20(b), none of the actions and communications described in (a)-(d) create a liability for the recipient in relation to the resources provided by the province.

Group members noted the announcement of a program by the government organization means the government organization is now a transferor. Paragraph PS 3410.24 addresses reporting by a recipient who uses the transferred resources to provide a subsequent transfer. When accounting for this second transaction, the government organization evaluates its circumstances in relation to paragraph PS 3410.12. The government organization would not record an expense for this subsequent transfer until there is authorization and the farmers have met all of the eligibility requirements. On this point, Group members expressed similar views. No liability would be recorded in the case of the circumstances described in (a) or (b). In the case of both (c) and (d), some Group members were of the view that a liability may have been created, but it would require more evidence for them to be certain the eligibility criteria had been met by the applicants.

Part 3:

In relation to Part 3, a Group member commented that a commitment to the general public provided stronger evidence that the government organization intended to move forward than communications with the transferring government alone. Otherwise, depending on the timing of conversations with the transferring government, one might view the objective as understanding the transferor's views on the recipient's eligibility. According to the standard, a term required and met before a transfer is provided is an eligibility criterion. A term met after a transfer is provided is a stipulation. In the case of a transfer recipient, only stipulations affect the recognition of a transfer in revenue.

Part 4:

Part 4 gave rise to a discussion about factors arising when the recipients of grants are controlled by the transferor. The Chair asked Group members to focus on situations where the grant recipient is a separate legal entity issuing its own general purpose financial statements. The requirements in Section PS 3410 that apply to a grant recipient controlled by a transferor do not distinguish from those that apply to entities considered to be at arm's length.

Some Group members noted that when a grant recipient is controlled by the transferor of a grant, the transferor has an inherent "right of return" of the assets provided in the transfer. As such, the funding agreement does not need an explicit return provision mandating the return of the funds if they are not used for the specific purpose. The funding government already has this power.

Other Group members took the view that the relationship between the parties should not affect how an amount is reported on by the controlled entity. Accounts should present transactions from the entity's own perspective. A Group member noted that if the entity's accounts were presented based on the perspective of the controlled entity, any resources provided by the controlling entity would need to be deferred. A view was expressed that notes can be included in the financial report to inform readers about related party transactions.

One Group member noted that governments often seek “fiscal alignment” in their accounts and the organizations they control. For some, this is a situation that is a source of concern when Section PS 3410 does not provide this result.

The Chair concluded that the reporting of transfers received by organizations that are controlled by the funding government may be a situation requiring further consideration by PSAB.

Section PS 3410: Whether the Authority to Pay Is a Requirement to Record a Transfer Liability

Paragraph PS 3410.28 sets out provisions designed to assess whether a transferring government has authorized a transfer for financial reporting purposes. Paragraph PS 3410.28 explains when authorization is considered to have occurred and that absence of the authority to pay may indicate that the exercise of authority is not complete. Paragraph PS 3410.12 requires a transferring government to recognize a government transfer as an expense in the period a transfer is authorized and all eligibility criteria have been met by the recipient. When the conditions in paragraph PS 3410.12 have been met but the transfer has yet to be remitted, the transferor would record a liability, based on the conclusion there would be little or no discretion to avoid payment of the grant in the future.

A presentation was received asserting that these requirements are being interpreted inconsistently. In the case of discretionary transfers, inconsistent applications can arise where the aforementioned accounting requirements conflict with legislation that requires an authority to pay (an appropriation).

The principal argument is that transfers are inherently discretionary and financial commitments are only valid when enabled by legislative authority. Although a government may commit to pay grants to recipients over many years, parliamentary authorization is required prior to each year’s payment.

The presenter referenced internal legal opinions of the ministère de la Justice du Québec, a legal opinion of an external legal firm and correspondence with accounting firms confirming the position of the ministère des Finances et de l’Économie du Québec, that the annual parliamentary supply vote is necessary for a government transfer to be considered authorized. These documents were received subsequent to the meeting.

The Group’s Discussion

The Group sought to distinguish the legal requirement for appropriation in advance of payment from financial reporting where liabilities are recognized to ensure the measure of financial position is complete. One Group member noted that, in some cases, the substance of the transaction and its legal form has the same meaning. In this regard, the need to record employee future benefit obligations and liabilities associated with contaminated sites were cited as instances where a liability would be recognized in financial statements notwithstanding that appropriation would be required prior to payment,. It was noted in the case of some programs, entitlement claims may exceed estimates. In such a case, the best estimate of the liability would be recognized, notwithstanding the need for a supplementary appropriation. The presenter expressed the view that the entitlement claims differ from discretionary amounts.

A discussion of various types of appropriations ensued. The presenter clarified the transfers at issue were those subject to a voted appropriation. It was stated that in the past, perhaps inadvertently, some organizations recorded these discretionary grants as receivables. The last budget of the presenter's government clarified that these are not government liabilities.

Group members discussed whether including a clause in the funding agreement stating that the funding was "subject to future appropriation" (or similar terminology) was sufficient for the government to have discretion to avoid payment of the funding. One Group member noted that it was commonplace for funding agreements of governments to contain such a clause. One Group member also noted that the past practice of the government could be an important factor in determining the strength of the clause. Another Group member indicated that this clause is important in assessing whether the government has lost its discretion.

When goods and services are provided to the government, Group members agreed that a liability would be recorded even if a future appropriation would be needed for payment.

The Chair acknowledged the possibility that practices may have evolved amongst jurisdictions and over time. It was also noted that application of Section PS 3410 turns on assessing when there is no longer discretion to avoid a liability.

The Chair indicated he would report to PSAB on the concerns associated with applying the wording in paragraph PS 3410.28.