PSAB
Public Sector
Accounting Board

PUBLIC SECTOR ACCOUNTING DISCUSSION GROUP

Report on the Public Meeting
April 26, 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

Cryptocurrencies – Accounting Treatment

A cryptocurrency is a digital currency exchanged on a blockchain platform, which is a decentralized online public ledger that records and validates transactions. Cryptocurrencies may be:

- acquired as an investment; or
- accepted as payment for goods, services, taxes, or user fees.

Given the shared characteristics of most cryptocurrencies, the submission and discussion focused on cryptocurrencies in general, rather than a specific cryptocurrency. The Group was asked to discuss two issues:

1. Do cryptocurrencies meet the definition of an asset?
2. If so, what kind of asset are they?

Members asked some clarification questions and received the following information:

- There are few cryptocurrency transactions in the public sector. Alcohol and cannabis sales may be future areas that will accept cryptocurrencies in payment.
- Accepting cryptocurrencies in payment of receivables for goods and services provided or taxes may comprise exchange of a stable asset for a potentially more volatile asset. The risks associated with cryptocurrencies would be downloaded to government if they are accepted for payments.

- Cryptocurrencies are relatively easy to convert to fiat currencies on a cryptocurrency exchange or through some banks. Faster conversion may be available through exchanges.
- Audit issues exist for entities that hold cryptocurrencies, especially verification of amounts held and their value.
- No hedges are currently available for a cryptocurrency holder to mitigate its exposure to volatility in a cryptocurrency's value.

The Group agreed that cryptocurrencies meet the definition of an asset, noting they do embody future economic benefits controlled as a result of a past event, being the acquisition of the cryptocurrency. There is belief in their value: Cryptocurrencies are

- bought and sold;
- used for goods and services;
- accepted by some cities as payment of taxes;
- used as a medium of exchange, such that one set of future economic benefits is exchanged for another; and
- converted easily to fiat currencies.

The Group considered whether cryptocurrencies are assets that are:

- cash or cash equivalents;
- financial instruments;
- inventories for resale; or
- intangible assets.

Discussions under other frameworks are considering classifying cryptocurrencies as intangibles. The Group acknowledged that the PSA Handbook does not currently allow recognition of intangibles in financial statements. However, the discussion should still consider if such classification would be appropriate in the public sector.

The Group first considered if cryptocurrencies are financial or non-financial assets, and thus if they would be included in the calculation of net debt. Generally, members felt they are more in the nature of financial assets, given they are a medium of exchange converted easily to fiat currency or goods and services.

The entity's intent for the cryptocurrency was explored. Members felt that public sector entities are unlikely to hold cryptocurrencies as investments, more likely accepting them as payment. Members also felt that cryptocurrencies received as payment would be quickly converted into fiat currency to minimize exposure to value fluctuations.

The discussion was inconclusive as to how cryptocurrencies should be classified. Members indicated that:

- Cryptocurrencies are not considered legal tender in Canada, so cannot be classified as cash.
- Cryptocurrencies' volatility would not currently allow them to be classified as cash equivalents. Nevertheless, the expectation that public sector entities would quickly convert them to fiat currency may mitigate the exposure to cryptocurrency valuation changes.
- If a public sector entity had a stand-ready third-party partner that would immediately convert all cryptocurrencies to fiat currency, the cryptocurrency's stability may not be an issue and it may be classified as cash equivalent. One Group member questioned whether this fact pattern comprises two transactions whereby the sale of the cryptocurrency to the third party would be a separate transaction from the original transaction to acquire the cryptocurrency.
- Cryptocurrencies do not meet the definition of a financial instrument because no identifiable contractual arrangement exists with another party.
- There is an argument for classifying cryptocurrencies as inventories for resale as public sector entities are likely to hold them only briefly, converting them quickly to fiat currency. But Public Sector Accounting Standards (PSAS) do not include an inventory standard.
- Except for the fact that cryptocurrencies are not fiat currency, they are similar to foreign currencies:
  - Cryptocurrencies may meet the PSAS definition of foreign currency.
  - Cryptocurrencies are becoming more accepted as a unit of exchange.
  - Accepting them means accepting the same risks as foreign currencies.

  Further, fiat currencies that are unstable or subject to high inflation or deflation are still considered to be cash or cash equivalents, albeit issued by another country.
- There is some argument that a cryptocurrency is intangible in nature, but it is not clear that this designation would best reflect its substance in financial statements.
- Reference to the general application standard Section PS 3210, *Assets,* is likely appropriate in the absence of a relevant standard for cryptocurrencies. However, recognition, measurement, and audit issues would still be outstanding.
- If cryptocurrencies are recognized as assets and are measured at fair value, where would gains and losses be recognized – in the statement of remeasurement gains and losses or in the statement of operations?

Members acknowledged that the categories of assets in the submission and discussion were not exhaustive, and that forced classification of cryptocurrencies into one of these categories may not be appropriate. PSAB might need to identify a new category of assets to address digital currencies.

Section PS 3510: Taxes Levied for Specific Purposes

Increasingly, there are examples of governments levying specific taxes to fund specific assets or programs; single or multiple year levies; for services, to fund capital or incentivize behaviour. The PSA Handbook does not include provisions for taxes levied for specific purposes. The submission asked whether in some cases a government[1] could have an obligation to use taxes levied for specific purposes that meets the definition of a liability in Section PS 3200, *Liabilities*.

The Group had a wide-ranging discussion that referred to Section PS 3100, *Restricted Assets and Revenues,* Section PS 3200 and Section PS 3510, *Tax Revenue*. The Group reviewed six scenarios: scenarios 1-4 quickly to ensure Group members agreed with the submission conclusions that a liability would not arise under each scenario.

The Group agreed that a liability would not arise when a government:

1. allocates part of its general tax levy for specific purposes;
2. levies a tax for specific purposes, which is collected and used in the same fiscal year;
3. levies a tax for a specific purpose, but the government spends more than the amount collected from the levy in each fiscal year; or
4. levies a tax to pay off debt already issued to pay for buying or building a capital asset or contributing funds to buy or build it. Some Group members noted that if the tax was levied in advance of construction and no debt had yet been issued, segregation in reserves would be more appropriate than liability recognition.

Scenarios 5 and 6 included an authorized tax with an identifiable taxable event, levied for specific purposes. Details on percentage of the tax, who would bear it, and what it would be used for were clear. Scenarios 5 and 6 were distinct from each other only in that Scenario 6 included extensive public communications of the tax and its details such that expectations may be raised that the tax would be used as promised. The distinction was the degree of communication, expectation, and public reliance would be much higher under Scenario 6, compared with minimal to no explicit communication about the tax under Scenario 5. Such communication would need to consist of more than a marketing campaign and include public consultation and debate. This might affect whether reliance on the promise to use the tax as levied would be considered both reasonable and detrimental and so give rise to an obligation. Members felt that the extent of the government's actions and communications would have to be enough that the government is unable to avoid the obligation. Members referred to examples in paragraphs PS 3200.07-.17, including a need to consider past practices of the taxing government.

They also referred to Section PS 3100, specifically the underlying idea that a government cannot legislate its way into a liability so that revenue is deferred to future periods, nor can it make a promise

[1] A government or other taxing authority such as a school board, but not administrators of the tax system, such as the Canada Revenue Agency or *Revenu Québec*.

enforceable only through its own actions, creating a liability that results in deferral of revenue to future periods. External restrictions are required to support liability recognition under Section PS 3100.

In contrast, the liability definition in Section PS 3200 recognizes that a government may by its actions and public communications so raise expectations that a promise will be fulfilled that individuals would reasonably rely on that promise to their detriment. In such circumstances the government loses its discretion to avoid the obligation. In such cases, a liability would be created that would be settled by fulfilling that obligation. So, there is some inconsistency between the requirements of Sections PS 3100 and PS 3200.

Many members struggled to identify tax levies that are sufficiently strong and publicly communicated to give rise to a liability. They acknowledged that a government has a lot of scope to change its mind. Input from lawyers on the likelihood of a lawsuit might be weighed as part of the professional judgment.

One member noted that Section PS 3510 is a revenue standard that does not contemplate liability recognition. A conclusion that a liability would be recognized for a tax levied for specific purposes under Section PS 3200 would conflict with the requirements of Section PS 3510, which requires revenue recognition when the tax is authorized, and the taxable event has occurred.

Ultimately, the Group could not definitively conclude that a liability could arise for taxes levied for specific purposes, consistent with PSAB's conclusion when Section PS 3510 was developed.

Members asked to discuss a related issue at a future meeting: the distinction between a tax and a user fee, in particular when the efficiency and mandatory nature of the tax system would justify it being used to collect the user fee.

Section PS 3380: Developer Agreements and Contractual Rights

Section PS 3380, *Contractual Rights*, came into effect for public sector entities for fiscal years beginning on or after April 1, 2017.

For significant land-development projects, municipalities enter into a development agreement with private developers to:

- document the terms and conditions under which land development is to take place, such as the developers' responsibility to construct key infrastructure, including public facilities and water and wastewater assets; and
- identify any associated financial obligations.

A common feature of development agreements allows private developers to transfer acquired and/or constructed tangible capital assets to municipalities at a point in time, such as upon completion of key milestones or at the end of the development project. These asset handovers transfer the responsibility of operating and maintaining the assets in future periods to municipalities. They also enhance the municipalities' capacity to provide goods and services to residents. Prior to the issuance of Section PS 3380, municipalities often accounted for the transaction in the year in which they received the assets from private developers.

The Group was asked to discuss whether developer agreements fall within the scope of Section PS 3380 and if so, would they meet the disclosure requirements?

Members felt that development agreements would generally meet the definition of a contractual right. However, most members agreed that the revenue recognized when the assets are "donated" to the municipality under the agreement would not meet the requirements of paragraph PS 3380.12, which governs which contractual rights should be disclosed. That paragraph requires that the revenue arising in relation to a contractual right:

- be abnormal in size in relation to the entity's financial position or usual business operations; and
- govern the level of certain type of revenue for a considerable period into the future.

The revenue from the "donated" assets is one-time and would not be abnormal in size for most municipalities. Future property taxes will be levied on the properties served by the tangible capital assets received through the agreements, and user fees for water, sewer, and electricity may also be levied. However, property tax and user fee revenues are not generated as a result of the developer agreement nor is the level of these types of revenues governed by a developer agreement. And, the future costs of operating and maintaining the assets will be borne by the government.

The Group concluded that developer agreements would not meet the disclosure requirements of Section PS 3380. However, the Group felt that something should be disclosed about developer agreements, perhaps in aggregate, as they tend to be material and their omission might reduce transparency. But disclosures should not be overly detailed or optimistic regarding the success of the development or the receipt of assets, which may not be realized. Developments can be cancelled or delayed depending on market volatility. So, disclosures should reflect any uncertainties and estimates relating to agreements disclosed.

Sections PS 1000 and PS 1201: Accounting for Purchased Intangibles

PSAB stakeholders have asked why purchased intangibles acquired through an exchange transaction cannot be recognized in public sector financial statements as they are measurable at the price in the transaction. Purchased natural resources and Crown lands are recognized in the financial statements if they meet the asset definition and the general recognition criteria. The reasons excluding purchased intangibles from recognition are not clear.

Indigenous government stakeholders in particular have raised this issue with PSAB, indicating that some governments are capitalizing such licenses and accepting audit qualifications for not complying fully with PSAS to ensure their statements are complete.

- Indigenous governments have material purchased intangibles (e.g., hunting, fishing, and forestry licenses).
- These intangibles are purchased through exchange transactions; so, measurement is not an issue.

- Excluding purchased intangibles from being recognized as assets in Indigenous government financial statements does not provide good accountability information to Indigenous communities. Significant and expensive assets are invisible.
- Excluding them from recognition as assets affects key ratios that impact Indigenous government funding from other governments.
- Indigenous governments may borrow to purchase these licenses. The debt is on the statement of financial position, but the related asset is not.

Discussion by Group members indicated that provincial government entities may also have purchased intangibles for which similar issues exist (e.g., film and television rights, trade names, logos, and mailing lists, etc.) The previous Group discussion on cloud computing (October 27, 2015) was also mentioned.

The submission asked whether the presumption in the recognition prohibition related to all intangibles in *Financial Statement Concepts*, paragraph PS 1000.58, that there is an absence of appropriate public sector recognition and measurement criteria for intangibles is a rebuttable presumption for purchased intangibles. The implications of interpreting paragraph PS 1000.58 as a rebuttable presumption were unclear. The Group agreed that it was not a rebuttable presumption. PSAS do not include rebuttable presumptions and those in IFRS® Standards are clearly identified as rebuttable presumptions. Further, a new interpretation of paragraph PS 1000.58 as rebuttable calls into question previous interpretations as well as financial statements that excluded the items set out in paragraphs PS 1000.57-.58.

However, the Group felt that purchased intangibles were assets and should be recognized in public sector financial statements. It suggested that PSAB should initiate a project on accounting for purchased, developed, and inherited intangibles. In the meantime, the Board should consider initiating a narrow-scope amendment project to allow for the recognition of purchased intangibles, given the immediacy of the issue for Indigenous governments.

In encouraging PSAB to address purchased intangibles of Indigenous governments, the submitter and two Group members referred to Article 26 of the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP). It states that:

1. Indigenous peoples have the right to the lands, territories and resources which they have traditionally owned, occupied or otherwise used or acquired.
2. Indigenous peoples have the right to own, use, develop and control the lands, territories and resources that they possess by reason of traditional ownership or other traditional occupation or use, as well as those which they have otherwise acquired.
3. States shall give legal recognition and protection to these lands, territories and resources. Such recognition shall be conducted with due respect to the customs, traditions and land tenure systems of the indigenous peoples concerned.

Canada is in the process of implementing UNDRIP through Bill C-262, which will align and harmonize all Canadian laws with these principles and articles. Should the bill become law, there may be a conflict between PSAS and the law.

PSAB's International Strategy – Consultation Paper 2

PSAB asked the Group to discuss in a public forum a question relating to its second Consultation Paper, to be issued on May 8, 2019: *Reviewing PSAB's Approach to International Public Sector Accounting Standards*.

A summary of comments received on Consultation Paper 1 was presented to the Group. The comments showed that the distinctions between the options for a future PSAB international strategy were not clear enough. The Group was asked to consider if the distinctions between the options set out in Consultation Paper 2 were enough for readers to understand the alternatives to be considered by PSAB in deciding its new strategy. Members were not asked to express which strategic option they would support.

A Group member asked if the criteria for modifying an International Public Sector Accounting Standard (IPSAS) would be the same for Options II and III, indicating that a clear distinction in such criteria was not evident. The PSAB Director clarified that the criteria allowing the Board to modify an IPSAS would be less stringent under Option II. For example, under Option II, the Board would modify an IPSAS:

- if the principles in that standard did not align with the Board's conceptual framework and reporting model; or
- if more detail was needed in a Canadian context, or
- if there was a Canadian specific reason for departure.

In contrast, under Option III a narrower band of differences from IPSAS would be contemplated. Under Option III, the International Public Sector Accounting Standards Board (IPSASB) conceptual framework and reporting model would apply, and justification for changes to an IPSAS would be grounded in circumstances specific to Canada.

A Group member asked for clarification of the Option II approach to existing PSAS. The Director indicated that Option II is prospective, meaning that future standards would be based on IPSAS unless a Canadian standard is required. The Board would still be developing PSAS. However, if a priority for the technical agenda requires revising an existing standard, changes would refer to any relevant IPSAS if appropriate. Option III is retrospective and at a point in time Canadian public sector entities would transition to IPSAS, modified as allowed for Canadian circumstances. The Director also mentioned Volume 2 of Consultation Paper 2, which outlines differences between PSAS and IPSAS. It would be a reference for gaps in PSAS for which IPSAS would be considered as the first step in Option II, once a topic is a priority for the Board's technical agenda. Some members noted that it would be helpful to understand what the differences noted in Volume 2 mean for the public as financial statement users.

Some members expressed concern over options in which Canadian influence over standard setting would be reduced. One member noted that most differentiating characteristics of the options are focused on accounting, while elected and appointed officials may be more concerned about influence, characterizing Options II and III as follows:

- Under Option III, another standard setter gets first chance at setting the standard and then Canada gets to weigh in.
- Whereas, under Option II, PSAB gets first chance at setting the standard and so has more influence.

The benefits to Canadian public sector entities garnered from giving up influence should be stated. Examples such as aviation standards and internet protocols were cited. Aviation standards went global to ensure passenger safety. Internet protocols went global to support connectivity. In contrast, control over drugs remains Canadian because of a desire to better manage the health of Canadians and drug costs. Would global public sector financial reporting standards that permit intercountry economic comparability better support global economic security?

Another member noted that Option III would require rewriting of financial statements at some point in time, with significant cost to public sector entities. Whereas Option II would retain many familiar and supported aspects of the existing framework but leverage the IPSAS to issue more standards more quickly. The value of the big change under Option III for accountability to the public needs to be considered. Further, the member noted that most countries using IPSAS, as contemplated under Option IV or even Option III, do not have a strong public sector standard-setting function, but Canada does. The Director noted that there are degrees of adoption of IPSAS, with many countries retaining authority over standard setting as under Options II and III.

A member asked why differential reporting for different types of public sector entities or a tiered approach, such as in New Zealand, were not explored in the paper. The Director responded that different reporting for government not-for-profit organizations (GNFPOs) is mentioned as a possibility in the international strategy paper. Also, PSAB's three major strategies – conceptual framework and reporting model, GNFPOs and international strategy – are iterative. The Board would consider alternatives such as differential reporting and maybe even a tiered approach once it has heard more from stakeholders on the international strategy options and the GNFPO Consultation Paper (also issued in May 2019).