

Application of Section PS 1202, *Financial Statement Presentation: Classification of Assets and Liabilities as Financial or Non-financial*

Extract, Public Sector Accounting Discussion Group Meeting Report – May 28, 2026

Section PS 1202, Financial Statement Presentation, is effective for fiscal years beginning on or after April 1, 2026. Section PS 1202 introduces the notions of:

- restrictions and their related impacts upon the classification of financial and non-financial assets; and
- financial and non-financial liability classifications.

Given these amendments, public sector entities must re-evaluate how they classify financial and non-financial assets and distinguish between financial and non-financial liabilities. Under Section PS 1202, the calculation of net financial assets or net financial liabilities (previously referred to as the “net debt”) was revised to financial assets less financial liabilities. Accordingly, the distinction between financial and non-financial assets and liabilities is important as it directly impacts the net financial assets/liabilities indicator.

This submission’s purpose is to examine application examples under each of the following categories:

- financial versus non-financial liabilities: unearned revenue from membership fees; and
- financial versus non-financial assets: internally restricted endowments.

Financial and non-financial liabilities

Section PS 1202 introduced the classification of financial and non-financial liabilities to more clearly distinguish between liabilities that give rise to financial resource requirements from those that do not. These changes are intended to improve accountability, restore the meaning of the net financial assets/liabilities indicator, and enhance the usefulness and consistency of public sector financial reporting.

PSAB now distinguishes between financial liabilities and non-financial liabilities. Financial Statement Presentation, paragraph PS 1202.085 states that “[l]iability classification is determined by how the liability is expected to be settled.” Additionally, paragraph PS 1202.087 defines a financial liability as a liability that “is expected to be settled using existing or future financial assets.”

Finally, paragraph PS 1202.089 clarifies that:

A financial liability represents a financial resource requirement arising from past events. Settling the financial liability requires an outflow of existing or future financial assets, such as:

- a. repayment (e.g., of borrowing);
- b. a future expenditure or disbursement (e.g., to pay for goods and services acquired or received prior to the financial statement date);
- c. the satisfaction of financial performance obligations (e.g., providing goods and services that are financial assets, such as inventories for sale or assets held for sale, to a payor); or
- d. the satisfaction of restrictions and/or stipulations requiring future spending (e.g., applying operating transfers received, or buying or building an asset with a capital transfer received, or using other contributions received as specified).

Paragraph PS 1202.096 defines a non-financial liability as “a liability that does not meet the definition of a financial liability.” Furthermore, paragraph PS 1202.097 clarifies that “[a] non-financial liability does not represent a financial resource requirement. At the financial statement date, a non-financial liability is not expected, due to its existing terms and conditions, to be settled with an outflow of existing or future financial assets. No future expenditure or disbursement is required to settle a non-financial liability.”

Paragraph PS 1202.099 states:

A non-financial liability is expected to be settled over the term of an arrangement through:

- a. the obligated entity itself using of one of its non-financial assets or unrecognized economic resources, often to provide services (see paragraphs PS 1202.AG.04(a-b) and AG.22(a));
- b. the obligated entity providing access and revenue-generating capacity over an agreed-upon term to the private sector partner to infrastructure acquired by the obligated entity through the user-pay model of public partnership arrangement in accordance with PUBLIC PRIVATE PARTNERSHIPS, Section PS 3160;
- c. the obligated entity allowing an external individual or another entity (i.e., an external party) to use one of its non-financial assets or unrecognized economic resources (see paragraphs PS 1202.AG.04(c) and PS 1202.AG.20(a));
- d. the obligated entity providing an external party with certain rights of access (simple, exclusive, unrestricted, restricted, shared) to one of its non-financial assets or unrecognized economic resources (see paragraphs PS 1202.AG.04(d), PS 1202.AG.20(c) and PS 1202.AG.24-.25); or
- e. the obligated entity transferring a non-financial asset or unrecognized economic resource (e.g., when land or a developed intangible will be accepted by a counterparty as consideration in settling a liability – see paragraph PS 1202.AG.20(b)).

Given these amendments, public sector entities are now required to distinguish between financial and non-financial liabilities.

Note: the scenarios provided below are illustrative examples developed for the Group's discussion. The Group's comments and conclusions reached reflect the specific facts and circumstances of each scenario and may be subject to change if any of those facts and circumstances differ.

Scenario 1: Unearned revenue from membership fees – professional development

The Group was asked to consider the following scenario:

A public sector entity offers annual membership programs to individuals and organizations. In exchange for an annual membership fee, members are entitled to participate in a series of educational workshops, webinars, and networking events organized by the entity throughout the year. The performance obligation of the entity is to deliver these services, which include live virtual sessions and opportunities to connect with peers in the sector.

The entity employs paid instructors to deliver and co-ordinate these services. The membership fee does not entitle members to any rights to non-financial assets; instead, the fee is earned as the entity fulfills its performance obligation over the membership period by delivering the promised workshops and events.

The entity collects the annual membership fees at the start of the membership year. The annual membership fees collected are reported as unearned revenue and the revenue from membership fees is recognized as the services are provided, reflecting satisfaction of the performance obligation.

The entity applies public sector accounting standards (PSAS) without the PS 4200 series.

Issue 1 – Scenario 1: Professional development: Should the unearned revenue be classified as a financial or non-financial liability under Section PS 1202?

The Group was asked to discuss the following views relating to the classification of the professional development fees:

View A – Financial liability

Unearned revenue from the professional development membership programs should be classified as a financial liability. This unearned revenue is an obligation to provide services in the future by using staff and instructors. The obligation is settled by transferring cash to pay those staff and instructors, which aligns with the definition of a financial liability under paragraph PS 1202.0871¹. It is not considered a non-financial

¹ Paragraph PS 1202.087 states: "A financial liability is a liability that is expected to be settled using existing or future financial assets."

liability because the entity does not settle its obligation with a non-financial asset, which is a key requirement for classification as a non-financial liability under paragraph PS 1202.097.²

View B – Non-financial liability

Settlement of the professional development service obligation requires access and use of the public sector entity's infrastructure (e.g., IT systems and hardware for the live virtual sessions), which are non-financial assets. Accordingly, this meets the definition of a non-financial liability under paragraph PS 1202.097.³

View C – Other views

Specify financial liability or non-financial liability and provide supporting rationale for this view.

Summary

Some Group members supported [View A](#), citing the following considerations:

- settlement of the obligation requires a future outflow of financial assets (i.e., salary payments made to the instructors);
- the workshops, webinars, and networking events are live sessions, which means that instructors have yet to deliver the sessions with related salary payments and cash outflows to be incurred; and
- the substance of the transaction that the members are paying for is the delivery of the workshops, webinars and networking events, and financial assets would be used to settle this obligation. The use of the facility's IT systems, hardware, and the related costs are incidental to the delivery of these activities and does not represent the services that the members are paying for.

One Group member noted that even if payment for instructor salaries were not required (i.e., if the instructors were volunteers), they would still support View A. Delivering the services would still require the entity to use financial resources, such as costs incurred to develop content and deliver these services.

A few Group members raised that [View B](#) may be applicable if circumstances were different. For example, if the content were pre-recorded and delivered as online, on-demand services accessible at anytime, the IT systems and hardware could be interpreted as no longer incidental. Service delivery would rely upon pre-existing content and the use of digital platforms/infrastructure.

Another Group member emphasized the need to consider the context of each transaction. Specifically, if internal staff were to develop and deliver the live workshops, webinars, and networking events (i.e., instead

² Paragraph PS 1202.097 states: "A non-financial liability does not represent a financial resource requirement. At the financial statement date, a non-financial liability is not expected, due to its existing terms and conditions, to be settled with an outflow of existing or future financial assets. No future expenditure or disbursement is required to settle a non-financial liability."

³ See footnote 2.

of hiring external instructors, or trainers), their efforts would still give rise to staff payroll costs that must be settled through financial means.

A Group member noted that it may be challenging to determine the liability classification when there are both financial and non-financial components in a single performance obligation. This Group member acknowledged that this situation is addressed in a later discussion scenario.

Scenario 2A: Unearned revenue from membership fees – recreational facility

The Group was asked to consider the following scenario:

A public sector entity offers an annual membership program to individuals and organizations, granting access to a recreational facility owned by the entity. This facility is classified as a non-financial asset. The membership program includes two distinct tiers: regular and premium.

Under the regular membership tier, members receive access to the facility's amenities for the duration of the membership year. They may use the various spaces and equipment as part of their membership. The primary purpose of the regular membership is to provide ongoing access to the non-financial asset, and the entity's costs related to operating, maintaining, and staffing the facility are incidental to this service.

Under the premium membership tier, members receive all the benefits of the regular membership with additional privileges. Premium members have access to the facility's amenities and may also participate in scheduled drop-in activities, such as group fitness classes, throughout the year. This expanded tier enhances the membership experience by including drop-in activities in addition to facility access. The scheduled drop-in activities are optional and are additional benefits provided to the members together with the facility access. They are not considered to be distinct and therefore, there is no separate performance obligation associated with the scheduled drop-in activities.

For both tiers, the annual membership fee is collected at the start of the membership year. These fees are reported as unearned revenue and are recognized as revenue over the membership period as access rights are granted. The memberships do not involve the transfer of physical goods or financial assets; rather, they reflect the entity's obligation to provide ongoing access to the facility and, for premium members, additional experiences. The entity concluded that there is a single performance obligation associated with the annual membership fee.

The public sector entity applies PSAS without the PS 4200 series.

Issue 2 – Scenario 2A: Recreational facility: Should the unearned revenue associated with the regular membership be classified as a financial or non-financial liability under Section PS 1202?

The Group was asked to discuss the following views relating to the classification of the regular membership:

View A – Financial liability

Unearned revenue associated with the regular membership should be classified as a financial liability because the salaries incurred for the staff to maintain and operate the facility are settled using financial assets.

While the fact pattern describes these costs as incidental to the membership services, staff are integral to ensuring that the facility and its related equipment are all operating and appropriately maintained. Therefore, the performance obligation of providing access to the recreational facility and its related equipment could not be satisfied without the operational and maintenance services provided by the staff. Given this, regular-tier membership fees should be classified as a financial liability.

View B – Non-financial liability

Unearned revenue related to the regular membership fees for a recreational facility should be classified as a non-financial liability because the obligation is to provide access to and use of the facility, which is a non-financial asset. The liability is settled through the provision of access to a non-financial asset, rather than using existing or future financial assets, so it meets the definition of a non-financial liability.⁴ The unearned revenue is not a financial liability because it is not settled using existing or future financial assets.⁵

Additionally, the fact pattern notes that the facility's operating, maintaining, and staffing costs are incidental to providing access. Per paragraph PS 1202.AG.24,⁶ incidental operating or administrative spending that the

⁴ Paragraph PS 1202.096 states: "A non-financial liability is a liability that does not meet the definition of a financial liability."

⁵ See footnote 1.

⁶ Paragraph PS 1202.AG.24 states: "Operating or administrative spending that is minor or incidental and does not comprise a separable performance obligation could be incurred by the obligated entity over the term of an arrangement to:

- a. allow use of a non-financial asset or unrecognized economic resource over the term of an arrangement. The liability is settled through use of the asset or resource (e.g., consumption of its service potential), not through payment of incidental expenses.
- b. provide an external party certain rights of access to recognized non-financial assets, (e.g., land or a park) or to unrecognized economic resources (e.g., the electromagnetic spectrum) over the term of the arrangement. The liability is settled through providing access to the asset or resource, not through payment of incidental expenses.

Whether a requirement to incur operating or administrative costs that are more significant and not merely incidental comprises a separate performance obligation to be considered for liability classification purposes would be determined in accordance with REVENUE, Section PS 3400. The guidance relating to liabilities with financial and non-financial components in paragraphs PS 1202.105-.106 and PS 1202.AG.39-.40 may also be relevant in determining this."

entity incurs to allow the use of a non-financial asset over the term of the arrangement does not result in a financial liability classification, as the liability is still considered to be settled through use of a non-financial asset, not through payment of incidental expenses.

This view is also consistent with Illustrative Example 3, paragraphs PS 1202.IE.013-.IE.014.⁷

View C – Other views

Specify financial liability or non-financial liability and provide supporting rationale for this view.

Summary

Some Group members supported [View B](#), citing the following considerations:

- the fact pattern specified that the facility's operating, maintenance, and staffing costs were incidental to the provision of the regular membership services; consistent with paragraph PS 1202.AG.24,⁸ such incidental costs do not constitute a separate performance obligation;
- the fact pattern specifies that the unearned revenue is recognized over time and is settled through member access to the recreational facility, which is a non-financial asset; and
- the fact pattern is analogous with the illustrative example provided under paragraph PS 1202.IE.014⁹ where employee salaries incurred are incidental to the delivery of the primary performance obligation (i.e., access to the park). Accordingly, members supporting [View B](#) concluded that the unearned revenues relating to the regular membership represent a non-financial liability.

One member indicated that [View B](#) could be further supported if the regular membership included a non-refundable clause, prohibiting refunds for cancellations. Conversely, some Group members indicated if the fact pattern stated that refunds were provided for remaining term cancellations, they may support View A since an obligation to provide a future cash outflow would meet the definition of a financial liability.

⁷ Paragraph PS 1202.IE.013 states: "A park is a non-financial asset. A payor purchases a park pass from a public sector entity. The park pass provides the payor access to provincial parks for two years. The provincial parks are only open from the spring to fall of each year. The payor has unlimited use of the parks for two years when the parks are open for the season."

Paragraph PS 1202.IE.0.14 states; "The public sector entity's promise to the payor is to provide a service of granting access to the park any time during the season for the payor to use as and when they wish. It is a non-financial performance obligation because access is provided to a park, a non-financial asset, for the duration of the two-year arrangement (see paragraphs PS 1202.099(d), PS 1202.AG.04(d) and PS 1202.AG.25). This non-financial performance obligation would be classified as a non-financial liability. Any payment of salaries to employees to provide access to the park is incidental to the performance obligation (see paragraphs PS 1202.AG.04(e), and PS 1202.AG.23-.24). Access in this example means opening the park gate; it does not mean ensuring safe access or promising a certain level of park maintenance. Considering these is beyond the scope of the example."

⁸ See footnote 6.

⁹ See footnote 7.

Additionally, one member noted that [View A](#) may apply if the facility's operating, maintenance, and staffing costs were more significant (i.e., not incidental) to delivering its regular membership services (e.g., if the public sector entity owned multiple recreational facilities). A few other members added that although this fact pattern clearly identified that these costs were incidental, this determination is often more judgmental in practice and could be subject to different interpretations; accordingly, professional judgment is needed.

Issue 3 – Scenario 2A: Recreational Facility: Should the unearned revenue associated with the premium membership be classified as a financial or non-financial liability under Section PS 1202?

The Group was asked to discuss the following views relating to the classification of the premium membership:

View A – Financial liability

Unearned revenue should be classified as a financial liability because the scheduled drop-in activities constitute incremental costs incurred to attract individuals to purchase premium memberships. These activities are not merely incidental; they represent necessary expenditures that directly contribute to the value provided to premium members and the fulfillment of the entity's performance obligation of the premium membership experience. As settlement of this performance obligation requires paying staff salaries and instructor expenses to deliver the scheduled drop-in activities, the unearned revenue meets the definition of a financial liability.

View B – Non-financial liability

Unearned revenue related to premium membership should be classified as a non-financial liability because the obligation is settled through the provision of access to the recreational facility.

In the fact pattern, scheduled drop-in activities are optional and do not constitute a separate performance obligation. The drop-in activities enhance the overall member experience at the recreational facility but are incidental to the primary purpose of the membership, which is to provide access to the facility.

View C – Other views

Specify financial liability or non-financial liability and provide supporting rationale for this view.

Summary

Some Group members supported [View B](#), citing the following factors:

- paragraph PS 1202.AG.40¹⁰ clarifies that for classification purposes, a liability is not required to be subdivided beyond the performance obligation identified. Since only one performance obligation has

¹⁰ Paragraph PS 1202.AG.40 states: "When applying this guidance to performance obligations, the guidance in REVENUE, Section PS 3400, for identifying each distinct good or service promised to a payor that gives rise to a performance obligation should be

been identified (i.e., premium membership services), settlement of this performance obligation will be provided through access to the facility (non-financial asset);

- costs incurred to run the drop-in activities are incidental to the premium membership services provided; and
- the drop-in activities do not represent a distinct performance obligation and access to these drop-in activities is optional. Accordingly, the primary purpose of the membership remains as access to the facility.

A Group member questioned whether the financial component of the performance obligation (e.g., operating, maintenance and staffing costs) would be incurred regardless of the facility's membership mix (i.e., whether they are fixed costs), or if these costs could be specifically attributed back to the premium memberships. This Group member noted this may be another factor in determining the classification of the unearned revenue relating to the premium membership.

Scenario 2B: Recreational facility

The Group was asked to consider the following scenario when discussing its views:

Same fact pattern as Scenario 2A but in this scenario, instead of the scheduled drop-in activities, premium members get 10 free group fitness classes to be used any time during the membership period. The group fitness classes constitute a separate performance obligation.

In this scenario, there are two performance obligations associated with the premium membership fee: (i) access to the recreational facility, and (ii) 10 free group fitness classes. At initial recognition, the premium membership fee is allocated to each performance obligation based on their relative stand-alone selling prices.

applied. Each distinct good or service has a performance obligation that would be accounted for separately as a liability and classified as financial or non-financial. In applying paragraph PS 1202.105-.106 to performance obligations for classification purposes, a performance obligation identified and recognized as a liability in accordance with Section PS 3400 is not required to be subdivided further into financial and non-financial components for classification purposes. See paragraphs PS 1202.AG.14-.25, PS 3400.29-.34 and Appendix A to Section PS 3400 for identifying distinct goods and services that would underlie individual performance obligations.

- a. Classification as a financial or non-financial liability would be at the level of performance obligation identification required by Section PS 3400.
- b. Exchange transactions are defined in paragraph PS 3400.05 as not necessarily requiring exchanges of fair or equal value. So, it is possible that settling a non-financial performance obligation might require some future use of financial assets to completely fulfill the obligation, for example, in the case of government-subsidized goods and services provided to a payor. In such circumstances, performance obligations would not be subdivided further than required by Section PS 3400 purely for classification purposes."

Issue 4 – Scenario 2B: Recreational facility: Would your views change if two performance obligations existed under the premium membership?

The Group was asked to discuss the following views relating to the classification of the premium membership with two performance obligations:

View A – Both performance obligations are classified as non-financial liabilities

Unearned revenue associated with both the access to the recreational facility and the 10 free group fitness classes should be classified as non-financial liabilities.

The performance obligation associated with access to the recreational facility is settled through the provision of access to the recreational facility, which is a non-financial asset, meeting the definition of a non-financial liability under paragraph PS 1202.097.¹¹

The performance obligation to provide 10 free group fitness classes includes both financial and non-financial components. It is settled through payment to group fitness instructors (financial component) and granting access to the recreational facility (non-financial component) to conduct the group fitness classes. While paragraph PS 1202.AG.40¹² is clear that the classification should be determined at the performance obligation level and the performance obligation is not required to be further subdivided into financial and non-financial components for classification purposes, paragraph PS 1202.AG.39¹³ clarifies that considering the materiality of the individual components would be an important factor in determining whether a performance obligation is financial or non-financial in nature. Furthermore, paragraph 7.42 of the Conceptual Framework

¹¹ See footnote 2.

¹² See footnote 10.

¹³ Paragraph PS 1202.AG.39 states: “Paragraphs PS 1202.105-.106 acknowledge that some liabilities may have financial and non-financial components. Consideration would be given to the substance and proportionate materiality of the individual components in determining whether separation into components is practicable and appropriate. Immaterial components, even if separable, would not be reported or classified separately. Thus, the materiality of the individual components would be an important factor in determining this. For example:

- a. If a material component of a liability will be settled with financial assets, and if proportionately that component comprises most of the liability, with only an immaterial component being otherwise settled, then the entire liability would be classified as a financial liability.
- b. If a material component of a liability will be settled through any of the means set out in paragraph PS 1202.099, and if proportionately that component comprises most of the liability, with only an immaterial component being otherwise settled, then the entire liability would be classified as a non-financial liability. If administrative or operating costs to allow an external party to use or access an asset or unrecognized economic resource are minor and incidental to the obligation as a whole, they would not be reflected as a separate component of the liability (see paragraphs PS 1202.AG.23-.24).
- c. If a liability has both financial and non-financial components and each is material, it would be appropriate to classify each material component separately according to how it is expected to be settled.”

for Financial Reporting in the Public Sector¹⁴ also notes that materiality is considered from both qualitative and quantitative perspectives.

Given that:

- i. the payment to group fitness instructors is minimal when compared to the broader incidental costs of maintaining access to the recreational facility as a whole, and
- ii. the performance obligation to provide 10 free group fitness classes does not have a quantitatively material financial component,

access to the facility and the group fitness classes should both be classified as non-financial liabilities.

View B – Facility access is a non-financial liability and the free classes are a financial liability

Unearned revenue associated with access to the recreational facility should be classified as a non-financial liability for the reasons noted in View A. However, the unearned revenue associated with the 10 free group fitness classes should be classified as a financial liability.

The free classes represent a distinct service promised and constitute a separate performance obligation. While the payment to the group fitness instructors is quantitatively immaterial (as discussed in View A), the enforceable promise of the delivery of group fitness instruction cannot be satisfied without paying the group fitness instructors. The payment to group fitness instructors represents a qualitatively material financial component to settle the group fitness class performance obligation. Therefore, the unearned revenue associated with the free classes should be classified as a financial liability.

View C – Other views

Specify financial liabilities or non-financial liabilities provide supporting rationale for this view.

Summary

Many Group members supported [View B](#), citing the following:

- two distinct performance obligations exist under this scenario: (i) access to the facility (non-financial) and (ii) access the 10 group fitness classes. As the group fitness performance obligation must be settled in cash (i.e., salary payment for group fitness instructors), this represents a financial liability, even if it is not material;

¹⁴ Paragraph 7.42 of the Conceptual Framework for Financial Reporting in the Public Sector states: “Materiality would be considered from qualitative and quantitative perspectives. From a quantitative perspective, it provides a threshold or cut-off point for determining what information to recognize and report or disclose. From a qualitative perspective, an item may be considered material in substance even if the monetary value is not considered significant.”

- it is important to consider what benefits the premium members are receiving (i.e., substance of the transaction). Under this scenario, given that two performance obligations exist, the settlement for each performance obligation must be separately assessed;
- paragraph PS 1202.AG.22(b)¹⁵ clarifies that if a liability is to be settled through the payment of staff salaries, it should be classified as a financial liability; and
- the revenue recognition patterns differ between the two performance obligations (i.e., revenue relating to the premium membership is recognized over time versus revenue recognition for the 10 group classes are recognized upon the completion of each group session), thus further delineating that each performance obligation is separate and distinct from the other. Additionally, as the premium members are paying a premium over the regular members to access 10 group fitness classes, they will be more motivated to attend these drop-in classes, thus further supporting the rationale for assessing the settlement of this separate performance obligation.

Other Group members supported [View A](#), citing the following factors:

- The fact pattern provided is very similar to that provided under [Issue 3](#), with the only distinction being that the group sessions are limited to 10. Accordingly, the same arguments applied under Issue 3 would also be applicable to support classifying the unearned revenues for both the group sessions and facility access as non-financial liabilities. A Group member noted that their conclusion might differ if the additional benefits offered were qualitatively different from group classes as described under Issue 3 (for example, personal training sessions, which would deliver greater value than a group session). Based on the current fact pattern provided however, it is difficult to distinguish this scenario from that outlined under Issue 3.
 - Paragraph PS 1202.AG.39(b)¹⁶ clarifies that separating the classification of a liability is not required for a non-material portion of a liability that will be settled in a different manner than the whole of the liability. In this scenario, the performance obligation relating to the 10 group classes is not material, nor are the costs incurred to satisfy this performance obligation. Accordingly, the unearned revenue relating to the group classes can be classified as a non-financial liability.

¹⁵ Paragraph PS 1202.AG.22 states: “Service delivery involves the application of labour, materials or capital assets (e.g., buildings or equipment) or some combination of these to supply the needs of a client, often a payor or a payor on behalf of third-party clients. For example, an obligated entity might choose to provide the required services:

...

(b) by using staff to deliver the required services. If the obligation to provide services meets the definition of a liability, it would be settled by paying the staff to deliver the services and is likely financial.”

¹⁶ See footnote 13.

- Separately measuring or apportioning the revenues relating specifically to the group sessions may prove to be challenging and difficult to manage in practice.

One Group member also acknowledged that in practice, materiality will be an important consideration when identifying performance obligations and determining their related classifications under Section PS 1202.

Financial and non-financial assets

Section PS 1202 distinguishes between a financial and non-financial asset to identify which assets can be used to discharge existing financial liabilities or fund future operations from those that cannot. Consistent with the introduction of financial and non-financial liability classifications, the notion of restrictions and their related impacts to the classification of financial and non-financial assets, are intended to improve accountability, restore the meaning of the net financial assets/liabilities indicator, and enhance the usefulness and consistency of public sector financial reporting.

Paragraph PS 1202.053 defines a financial asset as “an asset that could be used to discharge existing financial liabilities or spend on future operations and is not for consumption in the normal course of operations.”

Paragraph PS 1202.067 defines a non-financial asset as “an asset that does not meet the definition of a financial asset.”

Paragraph PS 1202.066 further notes that “[e]xternal restrictions placed on assets affect their classification as financial or non-financial.” For example, an entity may receive an asset for which access is externally restricted such that it cannot be used to discharge existing financial liabilities or fund future operations. As a result of the restriction, the asset would be classified as non-financial because it meets the definition of a non-financial asset in paragraph PS 1202.067.

Note: the scenarios provided below are illustrative examples developed for the Group’s discussion. The Group’s comments and conclusions reached reflect the specific facts and circumstances of each scenario and may be subject to change if any of those facts and circumstances differ.

Scenario 1:

The Group was asked to consider the following scenario:

A government not-for-profit organization (GNFPO) receives several contributions from donors. While some contributions are externally restricted for specific purposes (such as scholarships or programs), this GNFPO also has a policy whereby unrestricted contributions or funds can be designated as internally restricted endowments. For example, the GNFPO’s governing board decides to allocate a portion of its unrestricted contributions to create internally restricted endowment funds supporting a particular program initiative. These internally restricted endowment funds are invested in portfolio investments comprised of quoted money market and equity securities.

These internally restricted endowments are not subject to donor-imposed restrictions but are governed by the GNFPPO's policy and board resolutions, which limit their use to the specified program or purpose. Additionally, the GNFPPO's governing board retains discretion to remove the internal restriction on these internally restricted endowment funds. This means that while the funds are initially limited to specific programs or purposes based on board resolutions, the board may subsequently decide to remove these internal restrictions and access the funds, making the funds available for general use within the organization.

The GNFPPO applies PSAS without the PS 4200 series.

Issue 5 – Scenario 1: Should the portfolio investments internally restricted for endowments be classified as financial or non-financial assets under Section PS 1202?

The Group was asked to discuss the following views relating to the portfolio investments internally restricted for endowments:

View A – Financial assets

The portfolio investments internally restricted for endowments should be classified as financial assets because the restriction is internal only. The GNFPPO's governing board has the discretion to remove this internal restriction at any time. Even though the GNFPPO's intention is to maintain the portfolio investments permanently, the GNFPPO could access and use the portfolio investments to discharge existing financial liabilities or spend on future operations given this internal restriction. Therefore, the definition of financial assets is met.

View B – Non-financial assets

The portfolio investments internally restricted for endowments should be classified as non-financial assets because these funds are being considered as endowments, which by nature are held permanently. The portfolio investments cannot be accessed and used to discharge existing financial liabilities or spend on future operations. Therefore, the definition of non-financial assets is met.

View C – Other views

Specify financial assets or non-financial assets and provide supporting rationale for this view.

Summary

Some Group members supported View A, citing the following considerations:

- The restriction was internally imposed and thus can be similarly removed by the board at any time. Stated differently, this restriction is a management decision that is wholly within the public sector entity's control. Therefore, the portfolio investments are not truly restricted such that they cannot be

used to discharge existing financial liabilities or fund future operations. One Group member raised a real life example when a board subsequently appointed different board members who then decided to remove their self-imposed restriction, illustrating that changes in internal restrictions do occur. Additionally, management's intentions (for the future use of the endowment funds) should not determine the classification of the portfolio investments.

- If an internally restricted asset were permitted to be treated as a non-financial asset, this may result in management's ability to influence the net financial assets/liabilities indicator.
- The fact pattern explains that the board retains the discretion to remove the internal restriction and use the funds to support future operations. This is consistent with the definition of a financial asset as provided under paragraph PS 1202.053, which states that financial assets can be "used to discharge existing financial liabilities or spend on future operations."
- Paragraph PS 1202.066¹⁷ states that only external restrictions impact the classification of an asset. Accordingly, while the internal restrictions can be included within the financial statement note disclosures, they can not be used for asset classification determination.

¹⁷ Paragraph PS 1202.066 states: "External restrictions placed on assets affect their classification as financial or non-financial. The decision tree in Appendix B illustrates this.

- a. An entity may receive an asset for which access is externally restricted. That is, it cannot be used to discharge existing financial liabilities or spend on future operations (as noted in paragraph PS 1202.068(e)). Because of this restriction, this asset would be classified as non-financial, as it meets the non-financial asset definition in paragraph PS 1202.067. For example, externally restricted endowments that must be held in perpetuity may be non-financial assets, as the entity cannot access the assets (i.e., the entity cannot use the externally restricted endowment to discharge existing financial liabilities or spend on future operations). However, such endowments may be invested in items meeting the definition of financial instruments in FINANCIAL INSTRUMENTS, Section PS 3450 (e.g., portfolio investments). These financial instruments would be classified as non-financial assets. (See related guidance for liabilities in paragraph PS 1202.AG.09(a).)
- b. An entity may receive a financial asset for which its use, rather than the entity's ability to access it, is externally restricted. This could occur when an entity receives:
 - i. funds that are externally restricted to be used for a stipulated purpose, and that purpose:
 - a. has not been satisfied as required by RESTRICTED ASSETS AND REVENUES, Section PS 3100; and
 - b. does not involve the use of, or access to, a non-financial asset or an unrecognized economic resource;
 - ii. an operating transfer, until the transfer has been used for operations as required by GOVERNMENT TRANSFERS, Section PS 3410;
 - iii. a capital transfer or donation to acquire or develop a tangible capital asset, and that purpose has not been satisfied; and
 - iv. a capital transfer or donation to acquire or develop a tangible capital asset and then use it to provide services, and the initial stipulation related to using the financial assets to acquire or develop the tangible capital asset has not been satisfied. In these circumstances, the externally restricted asset received will be used to settle the related obligation or is available to spend on future operations or settle other liabilities. So, these types of externally restricted assets would be

One Group member noted that context matters and in other circumstances the classification may be less clear, resulting in View B as a supportable view. This member cited an example of a government changing its intended use of an asset (e.g., decision made to sell a tangible capital asset) and questioned whether this restriction change could result in a change to the asset's classification.

Another member extended this example and questioned what would happen if governments, in their governance and oversight capacity, passed legislation to change the intended use of an asset.

Under both examples, a few members questioned whether the government's ability to reverse legislation or make changes in their oversight capacity, would still be considered an "internal restriction" (i.e., what are the determining factors for differentiating between an external versus internal restriction for governments?); and what (if any) impacts to the asset classification could result from such restriction changes.

Another Group member analogized the legislation example to an entity's determination of constructive obligations, where determining whether an entity has a constructive obligation, and therefore cannot avoid paying out future cash flows, is a matter of professional judgment. Following this analogy, the Group member suggested considering legislation in the same manner (i.e., consider whether the entity uses professional judgment to assess the likelihood of whether a certain legislation will be reversed in the future or not).

Based on discussions, the Group recommended PSAB consider whether there may be any potential gaps in guidance on how to distinguish between "internal" versus "external" restrictions. This may include considering if any changes to these (e.g., legislative updates, revisions to decisions made by governments relating to the intended use of an asset), could affect the financial versus non-financial classification of the asset.

Scenario 2:

The Group was asked to consider the following scenario:

Same fact pattern as Scenario 1, but in this scenario, the internally restricted endowments are held in a trust with a legal arrangement such that the trust holds the funds permanently for a specific charitable cause, and the funds can only be accessed with the court's order. Getting court approval to take funds out of the trust is generally difficult and requires demonstrating that the original charitable cause is impossible or impracticable to fulfill.

classified as financial assets (see related guidance for liabilities in paragraphs PS 1202.AG.09(b)-(c), AG.30(d) and AG.36)."

Issue 6 – Scenario 2: Does your view change if the portfolio investments are held in trust with a specified legal arrangement?

The Group was asked to discuss the following views relating to the portfolio investments that are held in trust with a specified legal arrangement:

View A – Financial assets

The portfolio investments internally restricted for endowments should be classified as financial assets because the restriction is internal only. While access to the funds require a court order, the court order is viewed as an administrative matter.

The GNFPPO's governing board has the discretion to remove the internal restriction on the internally restricted endowments at any time. While there is a burden of proof requirement to support that the original charitable cause is impossible or impracticable to fulfill to gain access to the funds, this requirement still demonstrates that the restriction is not absolute or externally imposed, but rather an internal governance matter.

As a result, these assets remain under the control of the organization and can potentially be converted into cash or used to settle financial obligations, subject to administrative matters, including internal governance procedures and court order.

Therefore, the portfolio investments satisfy the definition of financial assets.

View B – Non-financial assets

The portfolio investments internally restricted for endowments should be classified as non-financial assets because the GNFPPO cannot access these funds without a court order. The burden of proof to support that the original charitable cause is impossible or impracticable to fulfill is a significant hurdle to access. These portfolio investments cannot be accessed and used to discharge existing financial liabilities or spend on future operations. Therefore, the definition of non-financial assets is met.

View C – Other views

Specify financial assets or non-financial assets and provide supporting rationale for this view.

Summary

Most Group members supported View B, citing the following factors:

- significant hurdles exist for the public sector entity to access the funds; therefore, the substance of the restriction is external in nature. Additionally, the entity's ability to access the funds is wholly outside of its control, and from the fact pattern provided, removal of the restriction would only be granted by the court under very specific and limited circumstances; and

- paragraph PS 1202.066(a)¹⁸ specifies that if an entity receives an externally restricted asset that can not be used to discharge existing financial liabilities or be spent on future operations, then the asset is classified as non-financial in nature.

A few Group members noted that if a true trust did exist, View C would be most applicable since a trust should not be reported within the public sector entity's financial statements. *Government Reporting Entity*, paragraph PS 1300.40, states: "Trusts administered by a government, government component or government organization should be excluded from the government reporting entity."

One Group member supported View A. This member identified the importance of reflecting the substance of a transaction over its legal form and noted that the entity's restriction remained internal in nature.

Accordingly, the member concluded that the same arguments provided under Issue 1 were all still applicable under this scenario as well.

¹⁸ See footnote 17.