Change in Control: First-time Consolidation of a Governmental Unit

Extract, PSA Discussion Group Report on the Public Meeting – July 17, 2020

ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, addresses situations in which a public sector entity acquires a governmental unit through a purchase by providing consideration. However, a public sector entity may have to apply consolidation accounting requirements after acquiring control of a governmental unit in a situation other than an acquisition. The submission set out a scenario in which a public sector reporting entity acquires control of another entity because of a change in the other entity's governance rules (as opposed to a reinterpretation of existing circumstances). For example, the reporting entity is now able to appoint a majority to the board of directors of the other entity. No consideration is exchanged. The change in governance is new information that impacts the reporting entity's assessment of the indicators of control in GOVERNMENT REPORTING ENTITY, Section PS 1300. The assessment concludes the entity is now controlled and is a governmental unit of the reporting entity. The newly controlled entity must be consolidated in the reporting entity's financial statements.

Standards do not explicitly deal with the accounting for this scenario. They merely recognize the possibility of an entity becoming eligible for inclusion in a reporting entity in the first sentence of BASIC PRINCIPLES OF CONSOLIDATION, paragraph PS 2500.07(e):

> Governmental units are included in government financial statements from the date of their creation or the date they became eligible for inclusion, and are removed from those financial statements from the date of their sale or other form of disposition or dissolution.

The submission made it clear that the consolidation is the result of new observable events that took place on a specific date, and not a review of the indicators of control that existed prior to that date. The scenario also indicated that the net value of the new governmental unit's assets and liabilities as at the date control changed is $5 million, which is material to the reporting entity's financial position.

The Group was asked to discuss two issues.

1. How should the impact of the initial consolidation of the newly controlled entity be recognized in the public sector entity's financial statements?
2. What should be the measurement basis for assets and liabilities subject to initial consolidation?

Issue 1

Regarding Issue 1, the Group considered three possible views:

A. Recognize a $5-million increase to the reporting entity's accumulated surplus as at the date control changed, without restatement of the financial statements of prior periods.

B. Recognize a restructuring transaction that gives rise to a $5-million revenue in the statement of operations as at the date control changed.

C. Recognize $5-million revenue for the accounting period in which the change in control occurred.

For Issue 1, the fair value and the carrying amount of the governmental unit's assets and liabilities were assumed to be equal.

In response to a Group member question, the submitter clarified that the newly controlled entity is assumed to continue its operations as before the change in control. Also, the reporting entity did not initiate the governance rule change that prompted the change in control. And it did not previously have the ability to initiate it.

Many Group members agreed that View A was most supportable; that it was a consolidation matter requiring an adjustment to accumulated surplus in Year 1 and consolidation adjustments thereafter. Two Group members also noted it as the more conservative option given that some specifics were not in the scenario. However, other Group members indicated that the PSA Handbook does not identify accumulated surplus or deficit as an element and only allows prior period adjustments in relation to changes in accounting policies or correction of errors or in scenarios meeting the description in the second sentence of paragraph PS 2500.07(e):

> If a governmental unit becomes eligible for inclusion as a result of a reinterpretation of existing circumstances, it would be included in the financial statements as if it had always been part of the government reporting entity. Such circumstances would, therefore, involve a restatement of comparative numbers.

A Group member noted it is important that the new governmental unit not be accounted for as if it has always been part of the reporting entity, as would be the case under View A and in the circumstances in the second sentence of paragraph PS 2500.07(e). There has clearly been a change in control, not a reassessment of existing factors.

Some Group members indicated that RESTRUCTURING TRANSACTIONS, Section PS 3430, did not apply to the scenario. They expressed concern that a specific transferor could not be identified as would seem to be required to apply Section PS 3430,[1] and that the scenario was not like an amalgamation,[2] also addressed the Section. However, one member questioned how the change in control occurred. Specifically, whether the change to the governance rules was decided by the former board of directors of the entity over which control was obtained. In such circumstances, the Group member thought the transaction would be more in the nature of a restructuring transaction. The former board of directors was making the decision and, thus, acting in the capacity of a transferor. Another Group member felt that a forced change in control could perhaps be analogized to an amalgamation of two local governments forced by the provincial government. Therefore, applying Section PS 3430 may best reflect the substance of the change in control.

---

[1] Paragraph PS 3430.02(d).

[2] Paragraph PS 3430.02(a).

Public Sector Accounting Board

Some Group members concluded that since the new governmental unit was expected to continue its operations unchanged after the change in control, then revenue recognition under View C is not appropriate. However, in line with the definition of revenue, other Group members noted that the reporting entity had experienced a net increase in economic resources because of the change in control and, thus, revenue recognition in the year control changed might best reflect the impact on the reporting entity.

In terms of suggestions to PSAB, Group members concluded that it would help to have clarity around the circumstances contemplated in the first sentence of paragraph PS 2500.07(e) (set out above) and direction on the appropriate accounting. Further, the Board could clarify if a transferor is required to apply Section PS 3430, or if it is possible to assume the existence of a transferor from the substance of certain change in control scenarios.

Issue 2

Issue 2 dealt with measurement. For Issue 2, the scenario was modified such that the carrying value of the assets and liabilities[3] of the new governmental unit are $5 million and their fair value $7.5 million. The Group was asked which measurement basis would apply at initial consolidation.

Building on their preferred views for Issue 1, most Group members agreed that using the carrying value was appropriate, especially when View A or B was considered the appropriate conclusion in Issue 1. A few Group members indicated that it would be illogical for there to be significant fair value adjustments in a situation in which no consideration was exchanged. However, some Group members supported using fair value when View C was considered the appropriate conclusion in Issue 1 or by analogy to an acquisition or a contributed capital asset.[4] One Group member indicated that using fair value would provide a better cost of service for the governmental unit when using its assets in providing future services.

[3] The carrying value attributed to identifiable assets and liabilities carried at cost.

[4] TANGIBLE CAPITAL ASSETS, paragraph PS 3150.14.