PUBLIC SECTOR ACCOUNTING BOARD
PSAB CCSP
CONSEIL SUR LA COMPTABILITÉ DANS LE SECTEUR PUBLIC

Feedback Statement

Public Sector Accounting Board

Post-implementation Review: Section PS 3410, Government Transfers

April 2016

Foreword

This Feedback Statement summarizes the findings of the Request for Information, "Post-implementation Review: Section PS 3410, Government Transfers," issued in November 2014.

The Public Sector Accounting Board's (PSAB) due process procedures require that:

> "PSAB carries out a post-implementation review of each new standard or major amendment. This is normally carried out two years after the new requirements have become effective. Such reviews consider whether a new or amended standard has been implemented and achieved the intended objectives established in the agenda setting and project planning stages. The reviews will also focus on important issues identified as contentious during the development of the pronouncement and consideration of any unexpected costs or implementation problems encountered in practice. A review may also be prompted by:
>
> (a) changes in the financial reporting environment and any regulatory requirements; or
>
> (b) comments made by PSAB, its task force members, AcSOC or stakeholders.
>
> The review may lead to additional issues being added to PSAB's agenda, with a view to providing an amendment or clarification to the standard."

Feedback received on a post-implementation review allows PSAB to assess:

(a) whether the standard resolved the issues that gave rise to the project and has been implemented, applied and interpreted as intended; and

(b) whether there are unexpected challenges in application or interpretation.

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Executive Summary

The findings of the Post-implementation Review confirmed earlier indications that the primary areas of concern with GOVERNMENT TRANSFERS, Section PS 3410, are recipient accounting for capital transfers, and the role of the “authority to pay” relating to authorization in one jurisdiction. Stakeholders generally did not have a major issue with implementing other changes or guidance in the revised standard. They indicated that the definitions of, and the distinction between, eligibility criteria and stipulations are particularly helpful.

Recipient accounting for capital transfers

Recipient accounting for capital transfers was the most contentious issue when developing the revised standard.

The revenue recognition principle in Section PS 3410 requires recipients to recognize transfers as revenue except when the transfer gives rise to a liability.

There were different views of how the liability definition can be met. Some respondents believed that the following would be necessary to meet the liability definition:

(a) a purpose or time stipulation with negative and enforceable consequences;

(b) stipulations that require a recipient to use, maintain and/or retain the tangible capital asset acquired or constructed with the transfer resources, with a requirement to return the transfer if it fails to comply; or

(c) stipulations that require a recipient to use, maintain and/or retain the tangible capital asset acquired or constructed with the transfer resources.

In addition, a few governments have introduced regulations to prescribe the accounting for capital transfers. Some transfer agreements have been amended to include a combination of the above stipulations to defer recognition of capital transfer revenue. Different types of audit opinions have been issued, some in accordance with the Canadian public sector accounting standards and others in accordance with the regulation that prescribes the accounting for capital transfers. Both qualified and unqualified audit opinions have been issued on financial statements reporting similar transactions and following similar accounting.

Authority to pay

Many transfer agreements contain an authority to pay provision. One respondent has introduced legislative changes that prohibit recipients, in certain situations, from recognizing a transfer receivable until the appropriations are voted. Some recipients have conformed their accounting to this legal requirement. Some auditors have interpreted that authority to pay is the enabling authority in transfer authorization. Others consider this provision to be more form than substance.

Qualified and unqualified audit opinions have been issued on similar transactions and accounting practices.

PSAB's assessment

Given the controversy with respect to recipient accounting for capital transfers and the principles-based nature of Section PS 3410, PSAB anticipated differing application issues when it approved the revised standard. The findings of this Post-implementation Review indicated that many stakeholders:

(a) were able to work through most of the principles and guidance in Section PS 3410, and LIABILITIES, Section PS 3200;

(b) remain unclear as to which stipulations and what level of their specificity give rise to a liability; and

(c) have spent significant time and effort debating issues that only PSAB can clarify.

Authority to pay was not an issue of concern when developing the standard. Most stakeholders did not have difficulty interpreting and applying the guidance. The findings of this Post-implementation Review confirmed that this is an issue primarily in one jurisdiction.

However, divergent practice and different audit opinions on the same set of fact patterns do not serve the public interest or meet users' needs. PSAB believes that issuance of authoritative clarifications would be necessary to resolve the different interpretations.

Background

Appendix A provides a background of Section PS 3410. Appendix B provides the timeline of the review.

Evidence gathered

Evidence gathered included:

(a) stakeholders' responses to the November 2014 Request for Information;

(b) past discussions of the PSA Discussion Group on topics related to Section PS 3410 (see Appendix C);

(c) financial statements of public sector entities;

(d) auditor reports and qualified audit opinions on government transfers issues;

(e) government transfers accounting policies and guidance issued by preparers and auditors;

(f) transfer agreements;

(g) legislation and regulations that address accounting for government transfers;

(h) PSAB's internal and external documents; and

(i) relevant standards and proposals issued by other standard setters.

Questions asked

The Request for Information contained eight questions.

Question 1 obtained background information about the respondent.

Question 2 requested information about the respondent's accounting for revenue recognition of capital transfers and related rationale.

Question 3 requested information about any challenges in applying the authorization guidance.

Question 4 asked if the respondent found the guidance on distinguishing eligibility criteria and stipulations useful and if they encountered any application challenges.

Question 5 requested information about the respondent's experience in implementing the new advance payment guidance.

Question 6 asked if the respondent has any challenges in applying other changes in Section PS 3410, such as recognizing a transfer of a tangible capital asset as expense at its net book value by the transferring government and removal of the reference to contingent recoveries.

Question 7 requested information about the effects (if any) of implementing the standard, for example, revisions to terms and conditions of transfer agreements.

Question 8 asked if the respondent has any comments not covered in the previous questions.

Respondents' profile

A total of 32 responses were received, well represented both geographically and by stakeholder groups. See Appendix D for the list of the 32 respondents.

Geographic representation		Stakeholder groups	
Canada wide	4	Senior government preparers	8
Federal government	2	Local governments	5
British Columbia	5	Legislative auditors	7
Alberta	3	Accounting firms	5
Saskatchewan	2	Government organizations	2
Manitoba	1	Government ministries other than Finance	3
Ontario	2	Other	2
Quebec	10	**Total**	**32**
New Brunswick	1		
Nova Scotia	1		
Newfoundland & Labrador	1		
Total	**32**		

Outreach activities

Staff took part in various discussions with stakeholders, involving controllers general, Offices of the Auditor General, local governments and various government organizations.

Findings and assessment

Recipient accounting for capital transfers

The most contentious issue raised was recipient accounting for capital transfers. Section PS 3410 requires that transfer revenue be recognized when the transfer is authorized and all eligibility criteria have been met, except when and to the extent that the transfer gives rise to an obligation that meets the definition of liabilities. That is, when the stipulations in a transfer, or the recipient's actions and communications together with the stipulations in a transfer, create an obligation that meets the liability definition in LIABILITIES, Section PS 3200.

Findings — changes made

The findings of the Post-implementation Review indicated the following:

(a) Many provincial governments and their government organizations have changed their accounting practices and removed any deferred capital contribution balances that do not meet the definition of liabilities upon implementing the revised standard. However, a provincial government did the reverse based on its auditor general's interpretation of the revised standard.

(b) At the time the evidence was gathered, four provincial governments and their government organizations have an accounting practice to recognize capital transfer revenue over the useful life of the related asset or a specified period beyond its acquisition/construction. Three of these jurisdictions have prescribed this accounting practice for their government organizations. One of these four governments received a qualified audit opinion on its financial statements because of this accounting practice.

(c) Provincial government organizations in the same four jurisdictions received different types of audit opinions, some in accordance with the Canadian public sector accounting standards and some in compliance with the regulation that prescribes the accounting for capital transfers. Both qualified and unqualified audit opinions have been issued on similar transactions and accounting practices.

(d) The municipal governments in the four provincial jurisdictions did not follow the same accounting practice as their provincial governments. No audit issue was identified in this Post-implementation Review.

Findings — responses

Responses to the Request for Information revealed that the different accounting practices were primarily due to different views of which stipulations and what level of their specificity would give rise to a liability.

(a) Some stakeholders interpreted that a purpose or time stipulation is not sufficient — negative and enforceable consequences would also be necessary to meet the definition of liabilities.

(b) Some stakeholders believed that stipulations that require a recipient to use, retain and/or maintain the tangible capital asset acquired or constructed with the transfer resources, with or without a requirement to return the transfer if it fails to comply, would be necessary to meet the definition of liabilities.

(c) Other stakeholders did not agree that these terms meet the definition of liabilities because a return requirement is not a present obligation, which is one of the three characteristics of liabilities. The recipient has discretion to avoid repayment when it receives the transfer resources. Also, using, retaining and maintaining tangible capital assets to provide services is part of a recipient's normal course of operation or asset management policy — they do not create new obligations to the recipient.

Some transfer agreements have been amended to include these stipulations to defer recognition of capital transfer revenue.

Assessment

PSAB anticipated debate over whether a transfer gives rise to a liability when it approved the revised standard. However, PSAB did not anticipate some jurisdictions would introduce a regulation to prescribe the accounting for capital transfers or that different types of audit opinions would be issued on similar transactions and accounting.

PSAB believes that different interpretations of the same set of fact patterns and different audit opinions on similar transactions do not serve public interest or meet users' needs. Also, a loose interpretation of the liability definition could potentially open the door to recognize more liabilities in the financial statements, resulting in distortion of key financial indicators such as an overstatement of the net debt. It can be argued that:

(a) if the responsibility to use and maintain tangible capital assets to provide future services creates a liability, similar liabilities should be recognized for all tangible capital assets owned by the recipient, regardless of the sources of funding for their acquisition or construction;

(b) if the requirement that the tangible capital asset acquired or constructed with the transferred resources is used to provide future services creates an implicit constructive obligation to the ultimate beneficiaries, the recipient should recognize a similar constructive obligation to the beneficiaries of all its programs; and

(c) if a stipulation that requires a return of all or part of the transfer resources if and when the purpose and/or time stipulations are not met creates a liability when the transfer resources are received, many contractual obligations would be recognized as liabilities prior to the occurrence of the triggering event.

Stakeholders' different views of which stipulations and what level of their specificity would give rise to a liability suggests a lack of understanding of the concepts underlying some definitions and principles in Section PS 3410 and, in some cases, in other standards. This is based on the following observations:

(a) The definition of stipulations contains the phrase "in order to keep the transfer." Though a return or repayment requirement is not listed as a type of stipulation in the glossary like a purpose stipulation or time requirement, there must be a requirement to return all or part of the transfer resources if certain terms are not met by the recipient to be considered stipulations.

(b) One of the characteristics of liabilities is that "the transactions and events obligating the government have already occurred." The relevant obligating event for repayment of transfer resources is when it is likely that the recipient will not meet the stipulations. The receipt of transfer resources is not the obligating event. Therefore, the existence of a return requirement does not give rise to a present obligation that would meet the definition of liabilities. The recipient has not lost its discretion to avoid repayment when it receives the transfer resources.

(c) By definition, tangible capital assets are held for use on a continuing basis and are not for sale. Purpose stipulations that require the recipient to use and/or retain the related tangible capital asset to provide services over its useful life do not give rise to an obligation that would require the recipient to perform something beyond what it would normally do or be required to do.

(d) By definition, government transfers are of a non-exchange nature — the transferring government does not expect a return of the transfer resources. A purpose stipulation that requires the recipient to use the related tangible capital asset to provide services over its useful life does not create a liability for the recipient to the transferring government. As noted above, even with a repayment clause, the liability is triggered when it is likely that the recipient will fail to comply. A purpose stipulation may give rise to a responsibility for the recipient, but this responsibility is not the same as an obligation to someone who has a claim on the recipient's assets or future services that leads to a liability.

Authority to pay

Authority to pay was not an issue of concern when developing the revised standard. In Section PS 3410, it is referred to as an issue that "may" need to be considered "in some cases" or "in other cases" for the purpose of determining when a government has lost its discretion to avoiding proceeding with a transfer.

Findings

The findings of this Post-implementation Review indicated that most stakeholders do not have issues applying the principles and guidance in the revised standard regarding transfer authorization both from the transferring government's and the recipient's perspectives. About one-third of the respondents to the Request for Information did not comment on this issue. Respondents from three jurisdictions commented on whether an authority to pay provision has substance.

Different interpretations of the role of the authority to pay relating to authorization have resulted in divergent practices and different audit opinions in just one jurisdiction. Authority to pay is interpreted as the enabling authority by the provincial government in that jurisdiction. The provincial government has also introduced a number of legislative changes that prohibit recipients of multi-year transfers (which include provincial and municipal government organizations) from recognizing a transfer receivable until the appropriations are voted.

That provincial government and its government organizations have not changed their accounting practice of recognizing transfer revenue and expense only when appropriations are voted and eligibility criteria have been met. The financial statements of the provincial government and some of its government organizations received a qualified audit opinion on this accounting practice.

About half of the municipalities and municipal organizations in that province changed their accounting practices to follow the province's direction as a result of the legislative changes. Some municipalities that are audited by both an external auditor and a general auditor received a qualified audit opinion from one auditor and an unqualified audit opinion from the other auditor. Qualified audit opinions were issued on the financial statements of municipalities and municipal government organizations regarding both accounting practices.

Stakeholders that supported the provincial government's view took a legal interpretation of the role of authority to pay. Other stakeholders recognized transfer revenue and receivables based on a preponderance of evidence that the enabling authority has been exercised by the government's actions and communications, and the eligibility criteria have been met.

Assessment

The debate over the role of the authority to pay relating to authorization was not anticipated by PSAB when it approved the revised standard. Underlying the authorization guidance for the transferring government in Section PS 3410 is the "loss of discretion to avoid proceeding with the transfer" concept. This phrase appears many times in the guidance. The revised standard is also very specific with respect to what constitutes transfer authorization for recipients. Authority to pay is not part of it.

An authority to pay provision, by itself, does not necessarily mean that a government retains its discretion to avoid proceeding with a transfer. The key is not about when the appropriation is approved, but when a government has lost its discretion to avoid proceeding with a transfer if and when the eligibility criteria have been met.

A transferring government would have a liability in advance of receiving the authority to pay when a recipient meets the eligibility criteria (for example, by incurring eligible expenditures or liabilities in accordance with the terms in the transfer agreement). A government may retain its discretion to avoid proceeding with a transfer until the authority to pay is in place before a recipient meets the eligibility criteria or when there is no eligibility criteria in a transfer.

The questions asked by stakeholders in the Request for Information indicated that the role of the enabling authority and an exercise of authority and their connection to the loss of discretion concept may not be apparent for some.

In most cases, determining when a transfer is authorized requires evidence that the enabling authority to enter into a transfer is in place and that the government has made a decision to provide a transfer. Since the government cannot provide a transfer prior to receiving the enabling authority, the timing of when a government exercises the enabling authority to provide a transfer is the crucial authorization event.

The approval or existence of an enabling authority — legislation, regulations or by-laws — provides evidence that a government has the authority to enter into a transfer. Actions and communications undertaken by the transferring government that would leave it with little or no discretion to avoid proceeding with a transfer when the eligibility criteria are met by the recipient would provide evidence that the government has made a decision to provide a transfer, that an exercise of authority has occurred and the transfer is authorized.

Next steps

PSAB will explore whether an authoritative accounting guideline would help clarify interpretations of Section PS 3410.

Appendix A: Background of Section PS 3410

The Government Transfers project was initiated in 2002 to address:

(a) inconsistent interpretation and application of the standard existing at that time; and

(b) the accounting for capital transfers and transfers of tangible capital assets as governments changed to the full accrual basis of accounting from the modified accrual basis of accounting.

PSAB undertook extensive consultation with stakeholders prior to issuing its first exposure draft in 2006, which included a stakeholder forum, a statement of principles and two associates' drafts. A total of four exposure drafts were subsequently issued to explore different options to address stakeholders' concerns regarding recipient accounting for capital transfers. The options explored range from a conceptually pure model to a deferral and amortization model, and from a prescriptive approach to an approach that allows flexibility in application and interpretation:

(a) The 2006 Exposure Draft allowed no exception to revenue recognition.

(b) The 2007 Exposure Draft allowed exceptions to revenue recognition when stipulations established performance and enforceable return requirements.

(c) The 2009 Exposure Draft allowed exceptions to revenue recognition when an operating transfer creates a liability in accordance with LIABILITIES, Section PS 3200; and required recognition of a deferred capital contribution for all capital transfers when the transfer is authorized and the eligibility criteria have been met.

(d) The 2010 Exposure Draft was basically the same as the proposal for operating transfers in the 2009 Exposure Draft.

After deliberation of the views and arguments put forward by stakeholders in their responses to the four exposure drafts, PSAB concluded that a consensus could not be reached on this issue. PSAB believed that Section PS 3410, as issued in March 2011, represented the most appropriate approach. It is consistent with the conceptual framework and allows the terms of each transfer to determine the pattern of revenue recognition.

Appendix B: Post-implementation review timeline

June 2014	PSAB approved a project proposal to undertake a post-implementation for Section PS 3410.
September 2014	PSAB approved the Request for Information.
November 2014	Request for Information posted online.
May 2015	Comment deadline – 32 responses received.
May to September 2015	Stakeholder consultation.
September and December 2015	PSAB reviewed feedback.
March 2016	PSAB approved this Feedback Statement.

Appendix C: Section PS 3410 issues discussed by the PSA Discussion Group

PSAB established the Public Sector Accounting Discussion Group as a regular public forum at which issues arising on the application of the CPA Canada Public Sector Accounting (PSA) Handbook can be discussed. Stakeholders have brought the following Section PS 3410 application issues to the Group.

Section PS 3410 Application Issues	Discussion Group Meeting Date
Recipient accounting for capital transfers	
Whether a liability arises from transfer stipulations that require the acquisition and use of tangible capital assets.	September 5, 2013
Which actions by and communications of a transfer recipient would evidence little or no discretion to avoid a liability.	September 5, 2013
How municipalities should account for the gas tax funding under the new federal agreement.	May 7, 2015
Authority to pay	
Whether the authority to pay is a requirement to record a transfer liability.	September 5, 2013
Whether a constructive obligation can give rise to a transfer expense and liability for the transferring government prior to an exercise of authority such as voted appropriations.	May 6, 2014

Appendix D: List of Respondents to the Request for Information

- Alberta Ministry of Seniors
- Alberta Treasury Board and Finance
- Bédard Guilbault Inc.
- BDO Canada LLP
- British Columbia Ministry of Advanced Education
- Centre de recherche Industrielle du Québec
- COMAQ
- Contrôleur des finances du Québec
- CPA Québec
- Deloitte LLP
- District of Mission, British Columbia
- Government of Newfoundland and Labrador
- Government of Saskatchewan
- Manitoba Finance
- Ministère des affaires municipales et de l'Occupation du territoire, Québec
- MNP LLP
- Nova Scotia Finance and Treasury Board
- Office of the Auditor General of Alberta
- Office of the Auditor General of British Columbia
- Office of the Auditor General of Canada
- Office of the Auditor General of New Brunswick
- Office of the Auditor General of Ontario
- Office of the Provincial Controller of Ontario
- Provincial Auditor of Saskatchewan
- Raymond Chabot Grant Thornton LLP
- Regional District of Nanaimo, British Columbia

- Regional District of North Okanagan, British Columbia
- SEPAQ
- Treasury Board of Canada Secretariat
- Vérificateur general du Québec
- Ville de Montréal, Québec
- Ville de Rosemère, Québec