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ASSURANCE AND ACCOUNTING

PUBLIC SECTOR ACCOUNTING STANDARDS (PSAS) UPDATE 2013

Introduction

During 2013, the Public Sector Accounting Board (PSAB or the "Board") made a number of revisions to the CPA Canada Public Sector Accounting Handbook (PSA Handbook). These changes will be discussed in this publication.

New and Amended Standards

First-time Adoption of Public Sector Accounting Standards by Government Organizations

Section PS 2125, First-time Adoption of Public Sector Accounting Standards (PSAS) by Government Organizations, applies to government organizations adopting PSAS for the first time. An amendment was made to this Section to clarify the interaction between the retroactive application requirements in this Section and the transitional provisions in new standards. As a result, if a private sector not-for-profit organization (NPO) becomes controlled by the government and has to adopt the PSA Handbook, on adoption it will follow the first-time adoption requirements in Section PS 2125 and it will also have to consider any new standards issued after August 2010 that it is adopting and ensure it follows the transitional provisions of those standards as well. The following standards were issued subsequent to August 2010:

- PS 3410, *Government Transfers* – Issued March 2011;
- PS 3450, *Financial Instruments* – Issued June 2011;
- PS 2601, *Foreign Currency Translation* – Issued June 2011;
- PS 1201, *Financial Statement Presentation* – Issued June 2011; and
- PS 3041, *Portfolio Investments* – Issued March 2012.

Changes Related to Financial Instruments

There was some confusion of the date for which Section PS 3450, Financial Instruments, and Section 2601, Foreign Currency Translation, were applicable for certain entities. To address this, the Board amended these two Sections to clarify that these Sections apply to fiscal years beginning on or after April 1, 2015. For government organizations that applied the CPA Canada Handbook – Accounting prior to adopting the PSA Handbook, these Sections are applicable for fiscal years beginning on or after April 1, 2012.

For example, governments (federal, provincial, local) and all entities not previously following the CPA Canada Handbook – Accounting adopt these standards for fiscal years beginning on or after April 1, 2015, while government not-for-profit organizations (GNPOs) adopted these standards for fiscal years beginning on or after April 1, 2012. For a more detailed look at Section PS 3450 refer to our publication "*A Guide to Accounting for Financial Instruments in the Public Sector*".

Section PS 3450, was also amended to address the accounting for gains, losses, interest and dividends when income attributable to a financial asset is externally restricted in accordance with the criteria in paragraph .11 of Section PS 3100, *Restricted Assets and Revenues*. The amendment requires that when there is an external restriction on a financial asset measured at fair value and the fair value change of that financial asset is also externally restricted, the change in fair value is accounted for as a liability instead of going through the statement of remeasurement gains and losses. The transitional provisions of Section PS 3450 were also amended to address accounting for the adjustments associated with the transition to this Section when income attributable to a financial asset is externally restricted.

Government Transfers

In March 2011, the Board issued Section PS 3410, *Government Transfers*, which replaces the previous Section PS 3410. This new Section applies to all public sector entities following public sector accounting standards. However, GNPOs that choose to apply PSAS with the PS 4200 Series of standards follow the guidance in PS 4210, *Contributions – Revenue Recognition*, to account for amounts received from a government. The new standard was effective for years beginning on or after April 1, 2012 so most public sector entities have had their first experience applying it during the current year.

The highlights of Section PS 3410 are as follows:

Transferor:

- A transferring government or government organization recognizes an expense when the transfer is authorized and the recipients have met any eligibility criteria.

Recipient:

- A recipient government or government organization recognizes the transfer as revenue when the transfer is authorized by the financial statement date by the transferring government or government organization and all eligibility criteria have been met, unless it meets the definition of a liability for the recipient.
- A liability related to the transfer may result from:
    - Receiving a transfer prior to meeting any eligibility criteria;
    - Specific stipulations contained in the transfer agreement; or
    - Unclear stipulations but the recipient creates a liability through its own actions and communications related or unrelated to the terms of the transfer by the financial statement date.

This new standard is complex and requires professional judgment in determining whether a liability exists. As a result, many entities have experienced challenges applying it during the current year.

The Board recently created a Public Sector Accounting Discussion Group to assist the Board regarding issues that arise in the application of the PSA Handbook. The discussions of the group do not constitute official pronouncements or authoritative guidance. At the group's first meeting on September 5, 2013 the group discussed the following issues that are complicating the determination of whether a liability exists under Section PS 3410:

- Whether a liability arises due to stipulations associated with a government transfer that requires the acquisition and use of tangible capital assets;
- Indictors of when the actions and communications of a transfer recipient evidence little or no discretion to avoid a liability; and
- Whether the authority to pay is a requirement to record a transfer liability.

We would encourage readers who are applying Section PS 3410 to read the minutes from this meeting which can be found under the "Standards for Public Sector Entities" section of the Financial Reporting & Assurance Standards Canada website (www.frascanada.ca), for the details of the discussion related to these issues.

For a more detailed look at government transfers please refer to our publications "*A New Government Transfers Standard*" and "*PSAB at a Glance: Section PS 3410 – Government Transfers*".

Tax Revenue

Section PS 3510, Tax Revenue, was issued by the Board in February 2010. The Section establishes standards on how to account for and report tax revenue in government financial statements. This new Section is effective for fiscal years beginning on or after April 1, 2012.

While governments with a March year end have already experienced applying this new Section, municipalities will apply PS 3510 for the first time to their December 31, 2013 annual financial statements. For a more detailed look at the effect of PS 3510 on municipalities please refer to our publications, "*Impact of the New Tax Revenue Standard on Municipalities*" and "*PSAB at a Glance: Section PS 3510 – Tax Revenue*".

Liability for Contaminated Sites

In 2010, the Board issued Section PS 3260, Liability for Contaminated Sites. This standard will be effective for years beginning on or after April 1, 2014, although early adoption is encouraged. While this standard is not yet effective, its complexity requires entities to begin considering the impact of the standard as soon as possible.

The standard explains when environmental obligations meet the definition of a liability; what is considered contamination; when an entity becomes responsible; how environmental liabilities should be measured given the uncertainties; and the disclosure requirements.

A liability for remediation may occur in the following situations:

- An operation of a government or government organization that is no longer in productive use (e.g. abandoned military installations);
- An operation of entities outside the government reporting entity that is no longer in productive use for which the government accepts responsibility (e.g. an abandoned gas station);
- Changes to environmental standards relating to an operation that is no longer in productive use (e.g. new regulations requiring the destruction of stored PCBs); and
- An unexpected event resulting in contamination (e.g. accidental toxic chemical spill or natural disaster).

An entity will recognize a liability for remediation of a contaminated site when all of the following are satisfied at the financial reporting date:

- An environmental standard exists;
- Contamination exceeds an existing environmental standard;
- The entity is directly responsible or accepts responsibility for the contamination or damage;
- It is expected that future economic benefits will be given up; and
- A reasonable estimate of the amount can be made.

Determining if contamination exists may take time and as a result, public sector entities should start the process now. The assessment of whether an environmental standard is exceeded may require site assessments and the use of experts. Uncertainty about the existence or non-existence of contamination does not eliminate the need to determine whether a liability exists and should be recognized. Instead, recognition depends on the probability that future site investigations will confirm that contamination that exceeds an environmental standard existed at the financial statement date.

The estimate of a liability includes the costs to bring the site up to current minimum standards for its use prior to contamination. The liability is estimated based on information available at the financial statement date. It represents management's best estimates at the financial statement date of the amount required to remediate contaminated sites (i.e. the amount that a public sector entity would rationally pay to settle or otherwise extinguish the liability at the financial statement date based on the best estimate of expenditures required to complete the remediation). To arrive at the estimate, the entity will have to use its professional judgment supplemented by experience, third party quotes and perhaps independent experts' reports.

For a more detailed look at this standard, please refer to our publication "*Liability for Contaminated Sites.*"

Financial Instruments, Foreign Currency and Financial Statement Presentation

As discussed previously, Sections PS 3450, Financial Instruments, and PS 2601, Foreign Currency Translation, are applicable for fiscal years beginning on or after April 1, 2015, for public sector entities that did not previously apply the CPA Canada Handbook – Accounting prior to adopting the PSA Handbook. Therefore, public sector entities that meet this criteria, such as governments, will apply these Sections for the first time for their March 31, 2016 year ends (for governments with calendar year ends, December 31, 2016 will be the first year end affected). At the same time public sector entities adopt these two Sections, they also adopt new Section PS 1201, Financial Statement Presentation. For more details on these standards please refer to our publication "*A Guide to Accounting for Financial Instruments in the Public Sector*".

Projects on the Go

Exposure Draft – Amendments to the Introduction

The Board issued this Exposure Draft for comment in early 2013. The Exposure Draft proposes amending the definition of a government organization to exclude entities that are actually component parts of a government. It does this by defining government organizations as separate entities with the power to contract in their own name and that can sue and be sued.

Clarification is also provided that when component parts of a government issue general purpose financial statements, they would follow the standards for governments supplemented by other appropriate accounting policies. The Exposure Draft proposes to add guidance on what standards government partnerships would follow.

In addition, general purpose and special purpose financial statements are defined. Clarification is also added that the PSA Handbook does not require government components, government organizations and government partnerships to prepare general purpose financial statements.

Re-Exposure Draft – Related Party Transactions

This Re-exposure Draft proposes the creation of a new standard on related party transactions, as currently PSAS does not contain such a standard.

Under the Re-exposure Draft, related parties are defined as:

- Entities that control or are controlled by a reporting entity;
- Entities subject to common control;
- Entities that have shared control over or that are subject to shared control; and
- Key management personnel and close members of their family.

Under the proposed new standard:

- Related party transactions, excluding contributed goods and services, would be recognized on a gross basis by both the provider and recipient organizations;
- A reporting entity may either disclose contributed goods and services or recognize them as revenue or expense;
- As a general rule, related party transactions would be recorded at the carrying amount. A transaction would be recorded at the exchange amount when it occurs in the normal course of operations or it results in a significant change in future economic benefits or service potential of the recipient;
- Fair value may be an appropriate measure of the exchange amount; and
- Only related party disclosures that are material require disclosure.

This proposed Section would apply to fiscal years beginning on or after April 1, 2016.

Statement of Principles – Restructurings

Currently there is no specific guidance on accounting for restructuring transactions in the PSA Handbook. Restructuring transactions include:

- Amalgamation of entities or operations;
- Annexation or boundary alteration between neighboring local governments;
- Transfers of operations or programs from one entity to another; and
- Shared services arrangements entered into by local governments in a region.

As public sector entities are entering into these types of transactions more often, guidance is needed to ensure these transactions are accounted for on a consistent basis. As a result, the Board issued a Statement of Principles earlier this year proposing a new Section on restructurings.

The Statement of Principles defines a restructuring transaction as a transfer of an integrated set of assets and liabilities, together with related program or operating responsibilities, that does not involve an exchange of significant consideration, which is determined primarily based on the fair value of the individual assets acquired and liabilities assumed. A restructuring transaction is defined separately from an acquisition.

The individual assets and liabilities transferred in a restructuring transaction would be recognized by the restructured entity at their carrying amounts. The difference between the total assets and total liabilities transferred in a restructuring transaction would be recognized differently depending on whether the restructured entity is considered a new entity or an existing entity. If it is considered a new entity, the difference is recognized in opening accumulated surplus or deficit. If it is considered to be an existing entity, the difference is recognized as revenue or an expense. In addition, if it is an existing entity:

- Any costs incurred related to the restructuring would be expensed when incurred;
- The accounting policies and circumstances at the restructuring date would determine the initial classification in the restructured entity's statement of financial position of the individual assets and liabilities transferred in the restructuring;
- The restructured entity's financial position and results of operations prior to restructuring date would not be restated; and
- The proposed standard would encourage but not require disclosure about the restructuring entities or transferred operations prior to restructuring date.

Statement of Principles – Assets, Contingent Assets and Contractual Rights

This Statement of Principles proposes adding three new Sections to the PSA Handbook on assets, contingent assets and contractual rights. The first proposed Section on assets would provide additional guidance on the definition of assets. Assets are defined as economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained. The proposed new Section would provide additional guidance on economic resources, control, past transactions or events, and future economic benefits. It would also require disclosure of unrecognized assets.

The second proposed Section to be added under this Statement of Principles is on contingent assets. Currently there is no definition of contingent assets in the PSA Handbook. This Section proposes defining contingent assets as possible resources that may result in future economic benefits arising from existing conditions or situations involving uncertainty. That uncertainty will ultimately be resolved when one or more future events not wholly within the public sector entity's control occurs or fails to occur. Resolution of the uncertainty will confirm the existence or non-existence of an asset. The proposed Section would also require disclosure when the occurrence of a confirming future event is likely.

The third proposed Section is on contractual rights. Currently the PSA Handbook provides a definition of contractual obligations, but no definition is provided for contractual rights. This proposed Section would define contractual rights as rights to assets and revenue arising from legally enforceable contracts or agreements that will, when the term of those contracts or agreements are met, become assets and revenue in either the same period or different periods. The proposed Section would also require disclosure of contractual rights in an entity's financial statements.

Statement of Principles – Revenue

Currently, the PSA Handbook does not include a standard on overall revenue recognition. As a result, many public sector entities need to consult other sources of GAAP when accounting for types of revenues for which the PSA Handbook does not provide guidance. The Board believes guidance in this area is needed as there is diversity in practice. As a result, a new revenue standard is proposed. This proposed standard would focus on two main areas of revenue:

- Exchange transactions and;
- Unilateral (non-exchange) transactions.

The proposed standard would define exchange transactions as transactions where goods or services are provided for consideration. These transactions create performance obligations for a public sector entity arising directly from a payment or promise of consideration by a payor. A performance obligation is defined as an enforceable promise to provide goods or services to a payor as a result of exchange transactions.

Revenue from an exchange transaction would be recognized as the public sector entity satisfies the performance obligation. An exchange transaction would be evaluated to identify goods and services that are distinct and would be accounted for as a separate performance obligation. An example of an exchange transaction is a user fee charged by a municipality for providing water services.

According to the proposed definition, unilateral revenues increase the economic resources of a public sector entity without a direct transfer of economic resources to the payor. The right to the economic resources is attributable to legislation grounded on a constitutional authority, or delegated constitutional authority, and an event entitling the public sector entity to recognize revenue.

Unilateral revenues are unique to the public sector as the authority to enact legislation is unique to governments. Unilateral revenues do not necessarily entitle the payor to a specific public service or benefit. Instead the public sector entity's right to the revenue results from its constitutional powers that allow it to impose the unilateral revenue. A public sector entity would recognize unilateral revenues when it has authority to the revenues and can identify a past event that gives it a right to those revenues. Tax revenue collected by a municipality is an example of unilateral revenue.

Statement of Principles – Improvements to Not-for-Profit Standards

The Accounting Standards Board (AcSB) which develops accounting standards for private sector NPOs and the Public Sector Accounting Board which establishes accounting standards for public sector entities, including government NPOs are working together to improve not-for-profit standards to better meet the needs of users.

Currently, some not-for-profit standards have requirements that differ from the conceptual frameworks on which Part III of the CPA Canada Handbook – Accounting and the PSA Handbook are based. To address this issue, the two Boards established a Joint Not-for-Profit Task Force to review the standards in the 4400 series of Sections in Part III of the Handbook (applicable for not-for-profit organizations in the private sector) and the PS 4200 series of Sections in the PSA Handbook (applicable to government not-for-profit organizations).

As a result of this project, the AcSB and PSAB have jointly issued a Statement of Principles – Improvements to Not-for-Profit Standards. This Statement of Principles contains fifteen proposed principles. Some of these principles apply to both private and public sector NPOs where user needs are considered to be similar, while others apply to only private or public sector NPOs where user needs are considered to be different.

The main features of the Statement of Principles that affect both private and public sector NPOs are as follows:

- Contributions:
    - The deferral and restricted fund methods of accounting for contributions would be eliminated;
    - A contribution would be recognized as an asset when the NPO has control of the contribution, would exercise that control if necessary, and can reasonably estimate the amount to be received; and
    - A contribution would be revenue, except when the contribution gives rise to an obligation that meets the definition of a liability.
- Capital assets:
    - The size exemption currently available for capital assets would be eliminated; and
    - A NPO would recognize capital assets in its statement of financial position regardless of its size.

The following features of the Statement of Principles affect public sector NPOs only:

- Accounting for tangible capital assets, controlled and related entities, and financial statement presentation:
    - A public sector NPO would follow the standards in the PSA Handbook currently followed by governments and other government organizations;
    - Current options available for reporting controlled and related entities by a public sector NPO would be removed; and
    - There would be a requirement for the financial statements to show the "net debt" indicator, a statement of change in net debt, a statement of remeasurement gains and losses, and present budget information.
- Intangibles, works of arts and historical treasures (including collections), and economic interests:
    - Until the Board can further consider these matters, such items would continue to be accounted for and presented on a basis consistent with the guidance currently in the PS 4200 series of Sections.

For information on the main features affecting private sector NPOs please refer to the Statement of Principles which can be accessed on the Financial Reporting and Assurance Standards Canada website or by clicking here.

As the proposals in the Statement of Principles could have a significant impact on accounting for both private and public sector NPOs we would encourage NPOs to watch this project closely.

Conclusion

As we head closer to the end of the year, now is the time to check with your BDO advisor about how the changes made and the upcoming changes to the standards affect your organization.