MARCH 2011
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ASSURANCE AND ACCOUNTING

PSAB UPDATE

Over the past year, the Public Sector Accounting Board has made a number of revisions, additions and deletions to the Public Sector Accounting Handbook. This publication provides an overview of these changes. Please contact your BDO advisor for further details.

Government Organizations

Government Not-for-Profit Organizations (GNPO)

In December 2010, the Board issued final standards for GNPOs. A GNPO is defined in the Public Sector Accounting Standards as an organization that has all of the following characteristics:

- It has counterparts outside the public sector;
- It is an entity normally without transferable ownership interests;
- It is an entity organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose; and
- Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

The NPO would also have to be controlled by a government to be considered a GNPO[1].

For year-ends beginning on or after January 1, 2012, GNPOs must move to either of the two following accounting frameworks:

- PSAB with the 4200 series of standards (Not-for-Profit specific standards); or
- PSAB without the 4200 series.

Early adoption is permitted. For more information on determining whether your NPO is a GNPO and to better under the differences between the framework not-for-profit entities previously followed and the new choices, see our BDO Publication entitled "Not-for-Profit Organizations: New Directions"[2].

Government Business-Type Organizations

In December 2009, the Board removed the classification for Government-Business Type Organization (GBTO) from the Public Sector Accounting Handbook. Previously, GBTOs were required to follow Part V of the CICA Handbook along with Government Business Enterprises (GBEs) and until the change in December 2009, GBTOs and GBEs were required to move to International Financial Reporting Standards for years beginning on or after January 1, 2011. Government business enterprises are still moving to IFRS. However, GBTOs will now have to determine if they are:

- A government not-for-profit organization (GNPO); or
- An "other government organization" (OGO).

The classification will determine which accounting standards the former GBTO will have to follow. An OGO is a government organization that is controlled by a government that is neither a GNPO nor a government business enterprise (GBE).

[1] This requirement is from Public Sector Standard Section 1300.
[2] http://www.bdo.ca/library/publications/assuranceandaccounting/documents/not-for-profit-organizations-new-directions_002.pdf

For year-ends beginning on or after January 1, 2011, OGOs must move to either of the two following accounting frameworks:

- PSAB; or
- International Financial Reporting Standards (IFRS).

The Introduction to Public Sector Accounting Standards suggests that IFRS may be the better choice for the users of the financial statements if the OGO:

- Has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market (for example, a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- Holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses;
- Has commercial-type operations and substantially derives its revenue from these activities; and
- Receives limited government assistance on an ongoing basis.

Former GBTOs, should talk to their BDO advisor about what type of entity they are now and which standards should be used in the future.

Rate-regulated Entities

Some rate-regulated entities meet the definition of GBEs and are therefore required to adopt IFRS. In mid-2010, the Accounting Standards Board (AcSB) decided to allow rate-regulated entities to defer adoption of IFRS for 1 year. As a result, they will not be required to adopt IFRS until fiscal periods beginning on or after January 1, 2012. These entities will still be allowed to adopt IFRS early if they wish. Rate-regulated entities will continue to apply the accounting standards in Part V of the CICA Handbook – Accounting, until the time they must transition, unless they adopt IFRS early.

As a result, these entities will have to disclose:

- Their choice to defer their IFRS changeover date; and
- When they will present their first financial statements in accordance with IFRS.

New Standards

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

This standard (PS2125) will apply to all government organizations adopting PSAB for the first time such as GNPOs and perhaps some former GBTOs. The standard is effective for year-ends beginning on or after January 1, 2011.

In preparation of the first financial statements in accordance with PSAB, government organizations would apply PSAB standards retroactively with restatement of prior periods, but to save preparers time, cost and difficulty in obtaining the necessary information to apply certain aspects of PSAB retroactively, the standard allows government organizations a choice to adopt some aspects of one or more of the following standards either prospectively or retroactively for:

- Retirement and post-employment benefits;
- Business combinations;
- Investments in government business enterprises;
- Government business partnerships; and
- Tangible capital asset impairment.

The standard also has exceptions prohibiting retroactive application for some aspects of standards relating to:

- Hedge accounting; and
- Accounting estimates.

Government Transfers

In February 2011, the Board issued its new Standard PS3410, Government Transfers, which replaces the existing PS3410. The Section applies to all governments and government organizations using public sector accounting standards. The standard is effective for years beginning on or after April 1, 2012; early adoption is permitted. Entities can choose to adopt the standard retroactively to prior periods or prospectively.

The highlights of the standard 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 transferring government (organization), unless it meets the definition of a liability for the recipient. The authorization has to be in place by the financial statement date.
- A liability related to the transfer may result from:
    - Receiving an asset 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 to the terms of the transfer by the financial statement date.

Stipulations are terms imposed by a transferring government regarding the use of the transfer or the actions a recipient must perform in order to keep a transfer. The recipient will have already met the eligibility criteria; a stipulation must be met after the transfer is provided. For example, a provincial government making a transfer to a municipality may stipulate how the transfer should be used by stating that it must be used for a particular activity or for a specific region or they may stipulate when the transfer may be used.

Liability for Contaminated Sites

In 2010, the Board issued PS3260, Liability for Contaminated Sites. This standard will be effective for years beginning on or after April 1, 2014, early adoption is permitted. While this standard is not effective for some time, its complexity requires entities to begin the work on adopting the standard as soon as possible.

The standard explains out 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.

An entity will recognize a liability when ALL of the following exist:

- 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.

An obligation for remediation of contaminated sites is not recognized as a liability unless all criteria above are satisfied.

Determining if contamination exists may take time and as a result, entities should start the process now. To assess if 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 would be recognized. 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 those costs to bring the site up to current minimum standards for its use prior to contamination such as:

1. Costs directly attributable to remediation activities such as:
    - Post-remediation operation;
    - Maintenance; and
    - Monitoring
2. That are an integral part of the remediation strategy for a contaminated site.

Costs of assets acquired as part of remediation activities to the extent those assets have no alternative use.

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 government would rationally pay to settle or otherwise extinguish the liability at the financial statement date based on 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.

Tax Revenue

PS3510, Tax Revenue, replaces its predecessor section and is effective for fiscal years beginning on or after April 1, 2012; early adoption is encouraged. The Section establishes standards on how to account for and report tax revenue in government financial statements. The main features of the new Section PS3510 are as follows:

- Tax revenue is grossed up for transfers made through the tax system;
- Tax revenue is not grossed up for the amount of tax concessions (that are often referred to as tax expenditures);
- Tax revenue is recognized when it is authorized and the taxable event occurs; and
- Tax revenue is recognized by the government that imposes the tax except in flow-through arrangements.

A taxable event is the moment that the government, legislature, council or other authority has determined something will be subject to taxation. These events are non-exchange transactions. There is nothing received in exchange for paying the tax. Some examples of a taxable event are:

- Income tax is the earning of taxable income during the taxation period by the taxpayer;
- Value-added or sales tax is the purchase or sale of taxable goods and services during the taxation period; and
- Customs duty is the movement of dutiable goods or services across the customs boundary.

One of the biggest areas of clarification is in determining the difference between a tax concession and a transfer made through a tax system. The reason that the distinction must be made is that the treatment on the income statement is different. A tax concession is netted against the type of tax revenue to which it provides relief (e.g. sales tax concessions or property tax concessions); they are preferential provisions of the tax law that are only available to taxpayers and can include exemptions, deductions, deferrals and credits that affect the level and distribution of tax. They may include special tax rates. They provide tax relief of taxes previously paid or currently owing and are seen as "foregone revenue". Transfers made through a tax system provide a financial benefit and are made for a purpose other than the relieving of taxes previously paid or currently owing. Transfers made through a tax system are treated as expenses in the income statement.

Removal of PS3800, Government Assistance: Application of CICA Handbook Section 3800

PS3800, Government Assistance: Application of a CICA Handbook Section 3800 was originally added to provide guidance to government business enterprises (GBEs) and government business-type organizations (GBTOs) on applying the recommendations of CICA Handbook Section 3800 in accounting for resources received from the government that owns or controls them. PS 3800 prohibited netting the proceeds of government assistance against the cost of the related capital asset because stakeholders were concerned that the full cost of capital assets would not be presented on the statement of financial position and the full cost of providing the program would be understated by the amount of the government assistance. The Section has been withdrawn because the GBTO classification is gone; and GBEs will be adopting IFRS for fiscal periods beginning on or after January 1, 2011. PS 3800 will remain in effect until the adoption of IFRS.

Upcoming Standards

Watch for standards related for Financial Instruments and Foreign Currency Translation later on this year. A financial instrument is a contract between entities that gives rise to an asset for one entity and a liability or equity interest for another entity. Financial instruments can be basic, such as an account receivable or an account payable, or more complex like derivatives. The financial instruments standard will provide recognition, measurement, presentation and disclosure requirements for financial instruments. The proposed standard will require the measurement of equities quoted in an active market and derivatives at their fair values, with changes in fair value going through a new statement called the statement of remeasurement gains and losses. The standard also adds disclosures to convey the financial risks associated with an entity's financial instruments.

Useful CICA Publications

The Public Sector Accounting Board has published some useful documents over the last year that are intended to help entities that are making the transition to PSAB. The first document, entitled a "Summary Comparison of the CICA Public Sector Accounting Handbook and CICA Handbook – Accounting (Part V) as of December 31, 2009" is a helpful document for those entities moving to PSAB to understand the basic difference. Note, however that the document does not take into account the addition of the 4200 series (GNPO standards) to PSAB. Another document entitled "20 Questions about the Government Reporting Entity" is very useful when an entity is trying to determine what entities are included in the government reporting entity.

The information in this publication is current as of April 14, 2011.