

## **PUBLIC SECTOR ACCOUNTING DISCUSSION GROUP**

### **Report on the Public Meeting**

**April 8, 2021**

*The Public Sector Accounting Discussion Group is a discussion forum only. The Group's purpose is to support the Public Sector Accounting Board (PSAB) by enabling discussion in a public venue of issues arising from the application of the CPA Canada Public Sector Accounting (PSA) Handbook, as well as emerging issues and issues on which the Board requests advice. The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the Board. The Group discussions do not constitute official pronouncements or authoritative guidance.*

*This document has been prepared by staff and is based on discussions during the Group's meeting.*

*Comments made in relation to the application of the PSA Handbook do not purport to be conclusions about acceptable or unacceptable application of the PSA Handbook. Only PSAB can make such a determination.*

### **ITEMS PRESENTED AND DISCUSSED**

#### **Section PS 3280, Asset Retirement Obligations (AROs): Issues with the Modified Retroactive Transition Method**

ASSET RETIREMENT OBLIGATIONS, Section [PS 3280](#), added to the PSA Handbook in August 2018, is effective on April 1, 2022. One complex area of the standard is the modified retroactive transition method. Some entities raised two issues about applying this method for to:

1. A building constructed with asbestos before legal requirements for managing asbestos disposal were enacted.
2. A fully depreciated asset that is still in productive use.

#### **Issue 1**

Issue 1 asked when an ARO would exist and when amortization of it would begin in this scenario: a building was constructed with asbestos 20 years before legal requirements to manage asbestos disposal were enacted.

The specifics of the scenario were:

- Government A is adopting Section PS 3280 for the first time and has chosen to apply the modified retroactive method in paragraphs [PS 3280.69](#)-.71.
- All requirements of paragraph [PS 3280.09](#) regarding whether a liability for an ARO exists are present at the implementation date.

- Government A's building has an ARO related to an asbestos remediation estimated at \$1 million. In 1950, the building was constructed with asbestos. In 1970, the province enacted legal requirements to remove asbestos in a prescribed manner.
- Government A anticipates the asbestos remediation will occur in 2025, when it will disburse \$1 million to settle the obligation.

The Group was asked to consider two views:

- A. The ARO should be recognized as at the construction, or acquisition date. Amortization of capitalized ARO costs should start at the construction date (i.e., 1950 in this fact pattern).
- B. The ARO should be recognized at the date the legal obligation became effective. Amortization of capitalized ARO costs should start at the date the legal obligation was created (i.e., 1970 in this fact pattern).

A few Group members noted that ARO estimation has many assumptions and moving parts. The objective should be to recognize the obligation. Justifying either View A or B is possible. So, the recognizing the obligation should be prioritized over choosing the most theoretically pure or precise approach, especially if the differences in amounts recognized between the two Views are not material.

One Group member noted that, under View A, Government A might not have enough information to estimate the ARO as at the construction date in 1950. And, regardless, no legal obligation could exist before the legislation. So, View B is most appropriate. Another Group member countered that the damage to the asset requiring remediation when the asset is retired occurred at construction when the asbestos was used in the building. So, the liability should be recognized as at the construction date in accordance with View A.

Some Group members noted the preferred approach at implementation might be View A to get the obligation more easily on the books. But View B would be preferred for accounting for new AROs after the standard has been implemented. For example, View B would better reflect the substance if an entity were to purchase the asset after the asbestos legislation has been passed. Others argued for a consistent approach at implementation and going forward.

Further comments from individual Group members included:

- The intent of the modified retroactive transition method is to simplify the requirements of the full retroactive method.
- PSAB may want to clarify how paragraphs [PS 3280.17](#), [PS 3280.21](#) and [PS 3280.71](#) interact in the standard.
- ARO liabilities may fluctuate if new technologies emerge that reduce the ultimate cost of retiring the related assets.

Overall, many Group members supported View B, either as the only option or an acceptable option. Some other Group members thought View A was acceptable and pragmatic.

## Issue 2

Issue 2 asked how paragraph [PS 3280.30](#) would apply in recognizing an ARO if the related asset is fully amortized at the implementation date but remains in productive use.

The specifics of the scenario were:

- The scenario is a modification of the Transitional Provisions example in [Appendix B](#) to Section PS 3280, which assumes that the asset to which the ARO applies has remaining useful life. In contrast, the scenario in the submission assumed the asset is fully amortized yet still in productive use.
- An entity is adopting Section PS 3280 for the first time and chooses to apply the modified retroactive application provisions in accordance with paragraphs [PS 3280.69-.71](#).
- Section PS 3280 will be implemented on April 1, 2022. Therefore, for measurement purposes, the scenario uses information and assumptions to derive cash flow estimates related to an asset retirement obligation on April 1, 2022.
- The public sector entity did not recognize an ARO in the past. Significant assumptions are as follows:
  - The tangible capital asset related to the ARO was acquired on April 1, 1995, for \$4 million and was estimated to have a useful life of 20 years.
  - The entity uses straight-line amortization.
  - The depreciation expense for the asset was \$200,000/year.
  - The asset was fully amortized by 2015 but remains in productive use by the entity.
  - The entity estimates that the asset will be in productive use until March 31, 2025.
  - The entity incurred 100 percent of the ARO on acquisition of the asset (April 1, 1995).
  - As at April 1, 2022, undiscounted expected cash flows required to satisfy the ARO on March 31, 2025, are \$250 million.
  - The April 1, 2022, discount rate is 2.5 per cent.

Three views were considered regarding implementation on April 1, 2022:

- A. The ARO should be recognized in its entirety as a debit to accumulated surplus/deficit and as a liability when the standard is implemented.
- B. The ARO should be capitalized to the asset when the standard is implemented and amortized over the remaining period in which the entity expects to have it in productive use.
- C. The ARO should be capitalized to the asset upon its initial recognition (April 1, 1995), and the asset amortized over a revised useful life. Revise the asset's useful life and adjust the accumulated amortization and amortize the ARO over the remaining revised useful life (30

years being the period from April 1, 1995, to March 31, 2025). The change in useful life is treated as a change in estimate.

Most Group members preferred View C, indicating that a change in estimate is a more accurate and defensible approach than Views A and B. Although this option provides heightened transparency, it requires more work, and it is inconclusive whether it provides better information to users. View A was the next favoured option, given its practicality and focus on getting the obligation on the books but was the least technically strong option. View B was least preferred but deemed the simplest option to use if its effect was not materially different than View C. However, if View B has a material effect on amortization, it could unfairly penalize the entity's results over the asset's remaining productive life. In dismissing a possible fourth option, one Group member clarified that the scenario could not be considered a correction of an error as defined in ACCOUNTING CHANGES, Section [PS 2120](#), as the change in useful life was based on new and better information.

The Group asked PSAB consider if an update to TANGIBLE CAPITAL ASSETS, Section [PS 3150](#), is required to ensure a regular review of assets' useful lives. Two Group members indicated that the circumstances in which an asset's useful life might be amended under Section PS 3150 did not seem to address the scenario in question when applying Section PS 3280. Specifically, useful life only becomes important when new costs are added to the asset because of the ARO.

### **PSAB's Proposed Reporting Model: Two Exposure Draft Issues**

PSAB issued four exposure drafts in January 2021:

- One proposes a new [conceptual framework](#).
- Another proposes a new [reporting model](#) for all public sector entities.
- Two others set out consequential amendments related to the [conceptual framework](#) and [reporting model](#) proposals.

In the reporting model Exposure Draft, PSAB proposes to split liabilities into two categories: financial and non-financial. The Group was asked whether the distinction between them is clear and can be applied.

PSAB also proposes new guidance on the going concern assumption. The Group was asked if the proposed guidance is sufficient and appropriate for the public sector. Due to time constraints, the Group could not discuss this second issue at the meeting.

#### **Issue 1**

PSAB proposes to split liabilities into two categories: financial and non-financial liabilities.

- A **financial liability** is a liability that is expected to be settled using financial assets. Financial liabilities include but are not limited to financial performance obligations. (Paragraph.005(c) of the [Exposure Draft](#))

- A **non-financial liability** is a liability that cannot be settled through the use of financial assets but only through the use of non-financial assets or economic resources excluded from recognition in paragraph PS 1202.071. A non-financial liability does not represent a future financial resource requirement. Non-financial liabilities include but are not limited to non-financial performance obligations. (Paragraph.005(d) of the [Exposure Draft](#))

PSAB's primary reasons for doing so are:

- to ensure the net debt indicator reflects future financial resource requirements, its original meaning. What the indicator purports to show has been muddled by including liabilities that will not be settled through the use of financial assets; and
- to refine the net debt calculation to ensure only liabilities that represent future financial resource requirements are included in measuring the indicator.

The Group was asked:

- Do you agree with splitting liabilities into financial and non-financial?
- Is the distinction between financial and non-financial liabilities clear? Consider some examples from your own experience. Can you determine if the liability should be classified as financial or non-financial?
- If the distinction is not clear, how can the definitions and guidance be clearer?

One Group member asked for clarification on the extent of non-financial liabilities and the types of organizations in which they might exist. The submitters explained that the main examples of non-financial liabilities are:

- (a) liabilities settled through the use of a tangible capital asset acquired through a transfer;
- (b) non-financial performance obligation liabilities arising from the user-pay model of public private partnership arrangements; and
- (c) non-financial performance obligation liabilities that will be settled by providing an individual or another entity with a degree of access (simple, exclusive, unrestricted, restricted or shared) to certain rights or resources over the term of the arrangement.

For some senior governments and for many government-not-for-profit organizations (GNFPOs), example (a) is sometimes called "deferred capital contributions" or "spent deferred capital contributions". These can be material.

Two Group members questioned whether capital transfer-related non-financial liabilities may exist for local governments, as the illustrative financial statements in the reporting model Exposure Draft show deferred capital contributions for senior governments but not local governments. The submitters noted that input received from local governments during the project to develop GOVERNMENT TRANSFERS, Section [PS 3410](#), was that the liability related to a capital transfer is to buy or build the asset. Any expectation by the transferor that the asset will be used to provide services over its useful life is likely a

valid one. However, it would not create the type of obligation that meets the definition of a liability and can be recognized in financial statements. Local governments also told PSAB that they are capital intensive. Requiring deferral and amortization of capital transfers received over the useful life of the related assets would impose an administrative burden and add little accountability value to their financial statements. Nevertheless, Section PS 3410 would determine the nature and extent of a liability and its revenue-recognition pattern based on the terms of the transfer arrangement and any related constructive obligation the transfer recipient creates. The definition of a liability would have to be met, but it is possible for any public sector entity to have a liability related to a capital transfer received that would be recognized in revenue over the useful life of the related asset or another term specified in the transfer arrangement.

The Group supported the financial/non-financial liability split and the look of the restructured statement of financial position. Having more precision in the net debt indicator was cited as one reason for the support, as was consistency with the existing financial/non-financial asset split. One Group member commented that presenting liabilities in the two categories would be appropriate only if the items removed from net debt are material.

After discussing the intent behind the proposals and if they would change existing standards, the submitters clarified that the financial/non-financial split is merely a presentation requirement. The split would not override any existing standard, except in relation to presentation of liabilities on the statement of financial position. Once an entity has applied all other Public Sector Accounting Standards (PSAS) and has determined it has liabilities, then, for presentation purposes, it would consider whether to present each liability as financial or non-financial; and so inside net debt or outside of net debt. Regarding examples of performance obligations in REVENUE, Section [PS 3400](#), the financial/non-financial liability proposal would not require an entity to further split performance obligations beyond that already required by Section PS 3400 for transactions with multiple performance obligations.

The Group asked PSAB:

- to reconsider if the definition of a non-financial liability should refer to expectation, as the definition of a financial liability does. Is this difference appropriate?
- if the simple distinction between financial and non-financial assets could also be made for the financial/non-financial liabilities definitions.
- to consider whether the following examples would be appropriately classified, given the proposed definitions:
  - performance-type liabilities, originally intended to be settled without the use of financial resources, would be settled using financial assets if the expected terms and conditions of the (non-financial) liability were breached;
  - borrowings for capital;
  - unamortized debt premiums;
  - deferred rental income;

- lease inducements; and
- prepaid leases; and
- to explain why a statement of net debt was more appropriate than presenting this information in the notes and schedules.

### **Consultation Paper II, “Government Not-for-Profit (GNFP) Strategy”: Select Issues**

In January 2021, PSAB issued Consultation Paper II, “[Government Not-for-Profit Strategy](#).” The Consultation Paper proposes a strategy for the Board’s future work with GNFPs and requests input on the strategy and its implementation. The Board asked the Group to discuss select issues in a public forum:

1. Do you agree that the proposed GNFP Strategy of PSAS incorporating the PS 4200 series with potential customizations best meets the Canadian public interest?
2. Recognizing that the PS 4200 series needs to be reviewed, how should that review be undertaken? For example, is there a standard or topic that should be addressed first given the need for additional guidance on that topic, such as accounting for endowment revenue and assets? Or should the less-complex topics be addressed first to begin the process?
3. What are the advantages and disadvantages of providing customizations within PSAS for GNFPs and what are the implications for providing accounting customizations versus disclosure or presentation customizations only?

Given the short time for discussion, the Group was asked to consider concurrently all three questions in their comments.

One Group member asked for clarification of the term “customization” used in the Consultation Paper, noting it could be interpreted as meaning a different due process for PSAB setting GNFP standards. The submitter explained that customization of the due process is not intended; all the Board’s projects follow the same robust due process. Instead, any proposed customizations would be subject to the due process, including consulting stakeholders. Customizations could involve, for example, financial statement presentation specific to a type of entity, or including specific accounting principles or disclosures for a type of entity or transaction within a generally accepted accounting principles (GAAP) standard. In the case of GNFPs, customizations could respond to input received from those entities. The Board is exploring whether one size fits all, and if not, what disclosures, accounting treatments or presentation requirements might address GNFP issues.

Another Group member asked for clarification of the weighting, if any, used in the criteria for evaluating the options. Although the Consultation Paper deliberately did not weight the criteria, the submitter indicated that in his view, the following broadly reflects the criteria’s order of importance:

- financial statements users;
- comparability;
- consistency;

- sustainability; and
- transitional considerations.

A few Group members suggested that PSAB take a “big-bang” (i.e., all at once) approach to establishing the new GNFP standards, even if the initial proposals take longer to issue for comment than a piecemeal approach. This would allow entities to adopt an integrated set of standards at one time. Others suggested the Board take the time to do it right, looking at individual standards to ensure they meet the needs of GNFP users.

Two Group members discussed identifying the primary users, as this would drive the approach. If governments are the primary users, then less customization is likely appropriate because these users want comparability for the use of public funds within the government and for ease of audit and consolidation. If GNFPs are the primary users, more customization may be appropriate because these users may want consistency among all of one type of organization (e.g., universities) for which accountability to donors is key. Another Group member identified citizens as the ultimate users of GNFP financial statements, arguing the standards should focus on providing accountability to them. A few Group members noted the reporting model changes PSAB proposed focus on the public and their elected representatives as the primary users and may address some GNFP issues. So, PSAS may require less customization to meet their needs. One Group member suggested GNFPs should transition their own financial statements to the government’s accounting policies for consolidation purposes.

The submitter reflected that PSAB’s Government Not-For-Profit Strategy Committee evaluated comparability:

- for ease of audit and consolidation,
- by sector,
- by type of entity, and
- for private sector not-for-profit organizations (NFPOs).

The Committee concluded that no option would satisfy all comparability possibilities.

One Group member indicated that Option 1 still leaves open the question of what to do with the PS 4200 series in the PSA Handbook. Also, that Option 3 would result in too many GAAPs within one reporting entity, leading to user confusion and less accountability.

The Group supported the Consultation Paper’s recommendation for PSAB to adopt Option 2 as the go-forward strategy for GNFPs. One Group member suggested the Board consider whether each customization proposed should be required or optional and for which types of public sector entities. Further, the Board should consider the reality that a government, through control of its GNFPs, can get whatever information it wants; but donors cannot.

The Group asked PSAB to consider transitional implications to any new proposals for GNFPs that apply either PSAS alone or with the PS 4200 series.



The Group also suggested that if the Board takes a standard-by-standard approach, it should first address revenue recognition, including endowments. The submitter clarified that any new standards transitioned from the PS 4200 series to the main body of PSAS would be tested against the Board's proposed Conceptual Framework for consistency.