

Public Sector Accounting Discussion Group

Report on the Public Meeting

March 3, 2016

The Public Sector Accounting (PSA) 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 Handbook (PSA Handbook). 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 PSAB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of PSAB 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 at the October 27, 2015 Meeting

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ITEMS PRESENTED AND DISCUSSED

Professional Judgment

The exercise of professional judgement is required throughout the generally accepted accounting principles (GAAP) in the PSA Handbook. New and complex transactions and events increasingly demand the application of professional judgment. And such judgments need to be documented by preparers, as judgments made in relation to financial statements will be evaluated by auditors of the statements.

The International Auditing and Assurance Standards Board (IAASB) issued an Invitation to Comment, "[Enhancing Audit Quality in the Public Interest: A Focus on Quality Control, Group Audits and Professional Skepticism](#)," in December 2015. The professional skepticism of the auditor often arises in areas where a preparer has exercised professional judgment. Thus the question arises as to whether guidance to assist preparers in supporting the exercise of professional judgment may be timely.

Issue 1 – Is guidance on professional judgment needed for the public sector in Canada?

Three views were considered:

View A – No guidance is required

This view argues that providing guidance on the application of professional judgment is contrary to the whole idea of professional judgment within a principles-based standard-setting approach (i.e., setting rules for using professional judgment).

View B – Guidance would be helpful but should not be authoritative

This view recognizes that additional guidance on what to consider and how to document professional judgment decisions might be helpful and would not actually set rules for the application of professional judgment. Given proposed new guidance on professional skepticism, professional judgment guidance may be helpful to preparers in addressing any concerns raised by their auditors.

View C – Guidance is required and should be authoritative

This view asserts that a gap exists in the PSA Handbook. More guidance is needed on what is involved in the exercise of professional judgment and how to document such application.

Issue 2 – If guidance on professional judgment is desirable for the public sector in Canada, what type of guidance would be useful and what form should it take?

Three views were proposed for consideration. In all three views, a framework on applying and documenting professional judgment would be developed. The views considered the form that such guidance could take. The intent of the guidance would be to help preparers demonstrate that they have applied good judgment in resolving accounting and financial reporting issues within a framework of accepted guidance developed in a consultative manner. Auditors would also have reference to such a framework. The issue was submitted to the Group because a professional judgment framework might drive more consistency in judgments as well as related documentation.

A draft of possible proposals for a framework on professional judgment was provided to Group members to illustrate the kind of guidance that might be included in such a framework. They were based on the preparer guidance included in an August 2012 publication issued by the Institute of Chartered Accountants of Scotland, "[A Professional Judgment Framework for Financial Reporting](#)."

View A – Guidance should take the form of a Statement of Recommended Practice (SORP)

This view argues that the application of professional judgment is a non-financial application issue, and thus, is most appropriately set out in a SORP, which would establish a framework of accepted, albeit non-authoritative guidance.

SORPs are not mandatory or prescriptive and would be issued with respect to matters of reporting supplementary information beyond that presented in financial statements.

A professional judgment framework may not strictly fall within the scope of SORPs as it relates to items reported in financial statements. But it could constitute a new non-financial topic for a SORP. And non-authoritative guidance may be less intrusive to professionals for whom the exercise of professional judgment is an intrinsic part of their daily work.

View B – Guidance should take the form of a Guideline within GAAP

This view recognizes that SORPs are non-authoritative and that guidance on professional judgment might not fit within the parameters of a SORP. Proponents argue that preparers would get more assistance from a professional judgment framework within GAAP. A Guideline comprises an authoritative source from which to support any judgments made and documentation prepared.

Guidelines set out the Board's interpretations of existing standards, or its opinions on other issues of concern with respect to matters of financial accounting policies and disclosures for which the process of issuing exposure drafts and eventual standards does not apply or cannot be undertaken on a timely basis.

A Guideline on professional judgment fits within these parameters. It is less authoritative than a professional judgment standard in that Guidelines fall below standards in the GAAP hierarchy set out in Section PS 1150, *Generally Accepted Accounting Principles*. But, such a Guideline is still considered GAAP. Guidance on professional judgment would not mandate how or when professional judgment is to be exercised.

View C – Guidance should take the form of an accounting standard within GAAP

This view asserts that the application of professional judgment is integral to a principles-based standard-setting approach. Thus guidance around the application of professional judgment and the related documentation should also be explicitly set out in a standard.

The Group's Discussion

The Group discussed Issues 1 and 2 together.

Group members stated that the application and documentation of professional judgment transcends sector. It was noted that other standard setters have discussed professional judgment but no

authoritative material has been issued. Group members felt that PSAB should not be ahead of the curve in establishing authoritative material on this topic and questioned the appropriateness of issuing authoritative material. One noted the relationship between professional judgment and professional codes of conduct, and indicated that professional judgment should be stressed more in CPA training.

The Group's conclusion on both Issues 1 and 2 was that at the most a discussion paper on professional judgment should be drafted, but that nothing authoritative should be issued. Even though non-authoritative, a SORP was not considered appropriate given the objective of SORPs is to provide guidance for reporting outside of financial statements. Some Group members suggested that some mention of professional judgment, its role and documentation could be included in a revised conceptual framework.

The Group indicated that professional judgment is more of a training issue for new staff or staff that had not been put through full training such as that provided in professional development and coaching in a public accounting firm. One Group member noted that professional judgment arises only partly from training. If the acquisition of professional judgment were to be quantified, only about 10 per cent would come from training. About 20 per cent probably comes from coaching by more experienced staff and the majority comes from direct experience. It was noted that professional judgment is developed within the individual through training and experience, and thus, cannot be "standardized".

Concern was expressed with the guidance drafted for the Group's discussion in terms of the risk of it becoming a checklist, and thus, unintentionally reducing the actual application of professional judgment. Over-documentation of judgments where risk is low was also noted as a potential problem with formal guidance. One Group member noted that rather than an overarching professional judgment framework, guidance in individual standards might better help in the application of professional judgment by identifying considerations relevant to a specific topic. The indicators of control set out in Section PS 1300, *Government Reporting Entity*, were cited as an example.

The Group acknowledged that professional judgment and some of the aspects of making and documenting professional judgments would comprise a useful discussion/training topic for entities in all sectors.

Sections PS 1000, PS 1100 and PS 1300: The Definition of Government in Relation to First Nations Trusts

Many First Nations enter into land claim settlements with other governments. The monies from the settlement are typically put into a trust for the benefit of the First Nation. A trust agreement is drawn up, which outlines how the monies can be spent, and trustees are appointed. In some cases, these are appointed by the chief and council. In others, the trustees are elected separately by the members of the First Nation.

The issue submitted to the Group dealt primarily with the second situation. Diversity has been noted in the accounting for these trusts. Some First Nation financial statements are consolidating these trusts; others are not. Although not all trust agreements are the same, this diversity in accounting has been noted even when trust agreements have very similar terms.

The indicators of control in Section PS 1300, *Government Reporting Entity*, include multiple references to the term "government". So to properly assess the indicators of control, one must first properly interpret the meaning of the term.

The Group was not asked for a conclusion on whether these types of trusts are part of a First Nation government reporting entity. The question sought clarification solely on the meaning of the term "government" as it is intended to be used in the context of Section PS 1300.

The Group's discussion may equally apply to similar trusts of the Inuit or Métis that apply the requirements of the PSA Handbook.

Scenario

- A First Nations trust has been established to manage funds received through a land claim settlement.
- Trustees are elected by the members of the First Nation.
- The chief and council are also elected by the members of the First Nation.
- The trust is for the benefit of the members of the First Nation.
- The First Nation prepares its financial statements in accordance with the PSA Handbook.

Issue – How is "government" defined for the purposes of assessing the indicators of control in paragraphs PS 1300.18-.19?

Group members sought and received clarification on various matters before commencing their discussion:

- A question was raised about the history of councils taking over First Nations trusts, or dictating what is to be done with trust resources, or firing of trustees. It was noted that every effort is made in drafting the agreement to ensure the creation of an independent body of trustees when a trust is created. And trustees elected by members can only be removed by the membership at large. However, it was also acknowledged that councils may often have a significant influence over trustee actions.
- A Group member inquired about the signatories to such trust agreements. It was explained that in land claim settlements the monies are generally received from the federal government. And the signatories are normally the federal government, the chief and council for the relevant First Nation and an initial corporate trustee appointed until the election of trustees by First Nation members occurs.
- An additional question was raised regarding whether the same members that elect the chief and council also elect the trustees. And further whether the members electing the trustees are also the membership that will benefit from the trust. It was clarified that there are different First Nation structures. Many chiefs and councils are elected. But there are a lot that have a hereditary system in which a particular family holds chief status. When the chief and council are elected, the same

members vote for the chief and council and the trustees. When the chief and council are hereditary, the members elect only the trustees.

- It was further clarified that trust agreements are written to benefit the membership as a whole. Some may mandate a per capita distribution to members at their age of majority. Others may distribute some monies on a per capita basis but retain some funds for investment in the First Nation.
- Questions were raised about the types of settlements. It was noted that settlements vary across the country. Some may involve only funds to compensate for loss of land. Others may involve transfers of land and/or rights to resources in addition to funds.
- One Group member asked for clarification regarding a situation in which the trust has invested in a business venture. For example, would the trustees or the First Nation run the business and would control eventually rest with the chief and council? Although the question was outside of the narrow issue raised by the submitter, it was explained that typically expenditures of the trust other than per capita distributions would arise because of a request to the trustees (for example, a request from the chief and council to invest in the community). Trustees would consider the request, whether it is in compliance with the trust agreement and whether to provide funds or other resources to the First Nation.

Three views were considered:

View A – “Government” should be interpreted to mean the chief and council

Financial Statement Concepts, paragraph PS 1000.02, and *Financial Statement Objectives*, paragraph PS 1100.02, define government as:

“the elected and appointed policy-makers and administrators who together perform the executive function and are the preparers of financial statements.”

Interpreting the term “government” in Section PS 1300 to mean the elected chief and council is consistent with Objective 4 under “Legislative control and government financial accountability” in paragraph PS 1100.61 and the discussion of the public as a key financial statement user in paragraph PS 1000.15. Both discuss the accountability of the government for financial affairs, operations, resources and activities; responsibilities consistent with the executive function of an elected body for the whole of government.

A broader interpretation of “government” may result in the financial statements reflecting decisions made by those other than the elected chief and council, who are elected to make decisions for the First Nation as the executive function. The trustees are elected only to make decisions about the resources in the trust.

Similarly, neither senior nor municipal governments include the elected Board members, elected trustees and other elected governing officials of its components and organizations as part of the elected officials that form the government. These other elected officials do not perform the executive function for the whole of government, but only for a part of government.

View B – “Government” should be interpreted to mean all elected policy-makers and administrators that govern activities of the defined political unit for the benefit of the First Nation, including elected trustees of trusts

“Government” should be interpreted to mean all elected policy-makers and administrators that govern financial affairs and resources of the defined political unit (i.e., the First Nation). Thus, “government” should be interpreted to mean the elected chief and council plus the elected trustees of the First Nation’s trust. Consequently, the scope of entity reported in the First Nation’s financial statements would be the nature and extent of the financial affairs and resources that the chief and council and the trustees of the First Nation’s trust control.

Under View B, the trust is integral to the government and not a separate body. Thus, consideration is not required of whether the trust meets the definition of a trust under administration. Nor is consideration of the definition and indicators of control required. If the elected Trustees are considered to be part of the elected body that comprises the First Nation’s government, it is arguably inconsistent to assert that the trust is not part of that First Nation’s government reporting entity.

Proponents of View B also primarily look to the definition of government in paragraphs PS 1000.02 and PS 1100.02. However, they argue that these paragraphs do not refer to only one group of elected officials. If the trustees are elected by the same membership as the chief and council, the trustees would, in addition to the chief and council, also represent elected and appointed policy makers. The funds held in these trusts are for the benefit of the members of the First Nation, as are the other resources of the First Nation. So, the trust assets are considered public resources and the trustees are administering these resources for the First Nation.

View C – The definition of government is unclear. As a result, both Views A and B are acceptable interpretations

This view argues that the definition of government is unclear:

- The term “government” already has two meanings in the PSA Handbook: the elected body as defined in paragraphs PS 1000.02 and PS 1100.02, and the government reporting entity as used in most of the PSA Handbook except the transfer authorization paragraphs in Section PS 3410, *Government Transfers*.
- In paragraphs PS 1000.02 and PS 1100.02, the definition of “government” hinges on the role of elected officials and there are contradicting statements regarding the role of elected officials in the PSA Handbook.

Elected officials are identified as comprising the government in the definition of government in Sections PS 1000 and PS 1100 because they set policy, perform the executive function and prepare the financial statements. Yet, in paragraph in PS 1000.16, elected officials are identified as primary financial statement users that use the financial statements to hold the government accountable.

Elected officials (represented by the Cabinet of the party in power in senior governments) are ultimately responsible under law for the preparation of financial statements, which is the intent of the definition in paragraphs PS 1000.02 and PS 1100.02. In most cases, the elected officials do not undertake the

mechanics of such preparation and may be quite separated from the actual process. But they are responsible for making sure that the financial statements are prepared. And often such responsibility and preparation will involve financial statements both for the government as a whole and some of its components and organizations.

Elected officials are also expected to act on behalf of the public that elected them. Thus, as a group they receive the final financial statements as an accountability report that summarizes the financial effects of their decisions for, and the transactions and other events of, the reporting entity for the reporting period. And elected officials may use the information in the statements for decision-making too.

Elected officials have a dual role as both “management” and “user of financial statements”, as both decision-makers and those who hold the government to account on behalf of the public. This dichotomy works well at the provincial and federal levels because not all elected officials form the “government” and not all elected party members are part of Cabinet. At the municipal level and for many First Nations governments all elected officials generally form the “government”. So the distinction between the two roles of elected officials and the impact of that distinction on the definition of government is less clear at the municipal level and particularly for First Nations governments.

The Group’s Discussion

The Group’s discussion indicated that there was most support for View A. That is, that the chief and council should be considered to be the “government” for the purposes of applying the indicators of control in Section PS 1300 in relation to a First Nation’s trust of the type set out in the scenario.

The Group felt that the chief and council clearly perform the executive function and that the mandate of the trustees would be much narrower. Some Group members also noted that including trustees in the “government” as in View B would negate the reasons for a formal trust agreement (i.e., to separate the management of trust funds from the management of the other public resources of the First Nation). It was noted that the trust agreement sets up a fiduciary responsibility of the trustees. Members of the First Nation must agree to changes in the agreement or the trustees — thereby ensuring that the trust manages the resources entrusted to it for the benefit of the membership as a whole.

One Group member indicated that the separate election of trustees would not be enough to exclude the trust from the First Nation’s government reporting entity. There are examples of separately elected school boards that are nevertheless still part of a government reporting entity because of other aspects of their relationship with the government. The member indicated that it might be appropriate to choose View B if the trust agreement has insufficient rigour to prevent the chief and council from controlling, removing or managing the trustees. And since the same members elect both the chief and council and the trustees it is difficult to see the separation of the trustees from government of the First Nation. It was clarified that most of these trust agreements do have a lot of rigour and would include mechanisms to ensure the smooth functioning of the trust and manage the election of and resolve disagreements between trustees. The trusts are intended to manage themselves.

Group members indicated that the chief and council perform the executive function, have executive powers and broad authority, while trustees perform only their mandate and have limited powers. The

trustees do not comprise a government on their own; neither are they part of the government of the First Nation. One Group member noted that there is no collective control of collective resources. The trust agreement would establish separate control of trust resources even if the objective of both the chief and council and the trustees is to manage resources for the benefit of the First Nation.

A complicating factor raised by Group members was that the chief and council are signatories to the original trust agreement, and thus, would have some initial say in the purpose and design of the trust and the nature of the trustees. One Group member indicated that the chief and council being a signatory was an example of their executive powers and helps affirm the chief and council as the government. However, the chief and council being a signatory does not establish control over the trust by the chief and council or on its own require the trust to be included in the First Nation government reporting entity. Another Group member supported this conclusion, indicating that: the federal government and chief and council sign a trust agreement on behalf of a First Nation, trying to break a trust agreement would require the agreement of all signatories, and most trust agreements of this kind are “iron clad” once signed.

The Group discussed the possibility raised in View C that the definition of government is unclear in the PSA Handbook because:

- the term “government” is used in two ways; and
- elected officials are defined as comprising government but are also identified as primary users of the financial statements that hold the government to account.

In trying to establish the nature of the trustee group and whether they would form a government, Group members noted that local governments are under the authority of the provincial governments and First Nations are under the authority of the federal government. It was noted, however, that local governments have a distinct accountability to a broad electorate of their own and perform the executive function for their jurisdiction. First Nations governing bodies that are governments would have similar accountabilities and executive powers. But trustees do not have the same type and degree of powers. And, the nature of their accountability is narrower, even if they are accountable to the same electorate as the chief and council of a First Nation.

The majority of the Group agreed that View A was appropriate and that the trust would not comprise a government for the purposes of its own reporting. Further, the Group agreed that the next question is whether such a trust is part of the government reporting entity of the First Nation and would be consolidated in the First Nation’s financial statements.

Sections PS 1000, PS 3100, PS 3200 and PS 3210: Endowments – Selected Issues

In December 2010, when PSAB revised its Introduction to Public Sector Accounting Standards in the PSA Handbook, it directed government not-for-profit organizations (GNFPOs) for the purposes of preparing their own financial statements to use either:

- the PSA Handbook with the standards in the PS 4200 series of Sections on not-for-profit accounting (the PS 4200 series); or

- the PSA Handbook without the PS 4200 series.

The PSA Handbook only includes standards specific to the accounting for endowments in the PS 4200 series.

Some provinces have chosen to direct all of their GNFPOs to use the PSA Handbook without the PS 4200 series for preparing their own financial statements. The GNFPOs in those provinces need guidance on how to apply the PSA Handbook without the PS 4200 series to accounting for endowments.

Endowments do not have all the same terms and restrictions. The terms of endowments are becoming ever more creative in order to meet the needs of donors and those of the GNPFOs.

PSAB and AcSB will look at contributions, including endowments, as part of their respective projects on accounting standards for not-for-profit organizations. In the meantime, GNFPOs that use the PSA Handbook without the PS 4200 series and their auditors are dealing with the accounting for endowment contributions and the related endowment investments and income. The Group agreed to a discussion of this topic because the issues raised question the application of existing GAAP, and GNFPOs that use the PSA Handbook without the PS 4200 series and their auditors may benefit from discussion on and perhaps a common understanding of the issues they are facing.

Scenario

For the purposes of this discussion, it was assumed that:

- an endowment contribution has been received by a GNFPO;
- the endowment contribution was received from an external party;
- the original endowment principal is restricted in perpetuity; and
- restrictions on the use of the income from endowment investments may or may not exist.

Issue 1 – Does the organization control the endowment investments?

Group members sought and received clarification in relation to government involvement in endowment investments. For example, does the government have the ability to determine where funds are invested? Does the government ever change what has been done with the funds, such as repaying a donor after a receipt has been given? It was explained that once a donation has been made with the requirement that the principal be held in perpetuity and a receipt is issued, jurisprudence indicates that the donor cannot change what is done with the endowment, nor can the recipient. However, there may be cases where the endowment agreement includes a clause for return if certain obligations are not fulfilled. In addition, the courts may be an avenue to change the use of endowments funds if the evolution of laws or rights would demand such change.

Two views were considered:

View A – The organization controls the investments

This view argues that endowment investments are assets of the GNFPO that receives the contribution or to whom it is receivable. This view applies the guidance in Section PS 3210, *Assets*.

Endowments are received by the organization and charitable receipts issued by the organization. Endowments investment decisions are made by the organization. The resulting income benefits the organization and the organization can control access to the income, subject to the requirements of the endowment agreement. Depending on the endowment terms, there may be some obligation to top up the investments if investment returns are negative, so the entity might be exposed to risk of loss in relation to the endowment investments in some cases too. Proponents of this view believe that the endowments investments are controlled by the organization.

Further, inclusion in the organization's financial statements facilitates being transparent and demonstrates overall accountability for the endowment portfolio.

View B – The organization doesn't control the investments; they are assets held in trust

This view argues that the endowment investments are not assets of the GNFPPO itself but are assets held in trust.

By definition, endowments are assets where the contribution is held in perpetuity. The use of the endowment investments are directed by agreement with specific requirements related to the use of those assets. Endowment investments in this scenario are not available for use by the organization in regular operations because the principal is restricted in perpetuity. For that reason, the endowment investments are assets under trust administration, not assets controlled by the organization.

If the organization never has direct access to the endowment investments, it is questionable as to whether they can be assets of the organization. If endowment investments are essentially assets under administration rather than assets of the organization, it might be appropriate to consider them as akin to "economic interests" and disclose their existence in the notes to the financial statements rather than recording them as assets of the organization.

Under *Government Reporting Entity*, paragraph PS 1300.41, trusts administered by the organization would be excluded entirely from the organization's financial statements; they are not assets of that organization. The income from the investments would also be excluded from the organization's financial statements. The income would accrue to the beneficiaries of the trust.

The Group's Discussion

The Group agreed that endowment investments are controlled by the GNFPPO when they are received or receivable by that entity, and that they are assets of the GNFPPO.

The Group arrived at its conclusion by articulating the following:

- It is difficult for endowment investments to not be assets of the GNFPPO because there are existing not-for-profit standards wherein they are acknowledged to be assets, and the public sector not-for-profit standards in the PS 4200 series share a common conceptual framework with other standards in the PSA Handbook. The conceptual framework in the accounting standards for not-for-profit organizations in Part III of the CPA Canada Handbook – Accounting, is also fairly comparable to that in the PSA Handbook. Private sector not-for-profit standards also treat endowment investments as assets.

- The GNFPPO controls the investment policies and issues receipts for the contribution of resources when they are received.
- Restrictions on the use of contributed resources do not mean that there is no asset for the recipient organization.
- The GNFPPO holds the investments and benefits from the related income.
- If an endowment is not a legal trust, then it should not be characterized as such.

Issue 2 – If endowment investments do meet the definition of an asset for a GNFPPO, how should they be presented in the statements — as financial assets, or non-financial assets?

The answer may reference the types of assets (cash, equities, bonds, etc.) held in the endowment fund or it may depend on the nature of the restriction(s) on the use of the endowment assets. Restrictions do not change the nature of an asset but they may affect how the resources can be used.

Three views were considered:

View A – Endowment investments are financial assets

Endowments investments are normally cash or convertible to cash, equities, bonds, etc. Investments by their nature are generally considered financial assets. Classification of endowment investments should be based on the types of investments generally held in an endowment fund.

An organization with endowment investments generally manages them in the same fashion as other investments of the organization, taking into account the terms of the endowment. Like other investments of the organization, the resulting endowment income benefits the organization and the organization can control access to the benefits, subject to the requirements of the agreement. The related income is available to discharge liabilities and finance future operations even if the principal amount is restricted in application. Proponents of this view believe that managing endowments and making distributions from them are part of the operations of the organization.

Thus, the classification of endowments as financial assets for the purposes of reporting them in the financial statements is appropriate to the nature of the resources held in endowment funds.

View B – Endowment investments are non-financial assets

This view focuses not on the nature of the resources held in the endowment funds but rather on the definitions of financial and non-financial assets and the flexibility in application of each. *Financial Statement Objectives*, paragraph PS 1100.32, contrasts the nature of non-financial assets and financial assets:

“A key distinction between the financial and non-financial assets of a public sector entity is the degree of choice in application associated with them. Financial assets can be used to discharge liabilities or provide services, while non-financial assets can normally be used only for service provision.”

Investments that are related to the endowment principal are to be held in perpetuity and are not available to discharge existing liabilities or finance future operations. So they cannot be classified as financial assets. Thus, endowment investments must instead be reported as non-financial assets on the statement of financial position. This presentation makes it clear that these investments are not available for operating use by the organization.

In addition, net debt is a key indicator used by public sector entities as it provides a measure of the net recognized economic resources available to the organization at the financial statement date to discharge existing liabilities or provide services in the future. If the endowment investments are included in financial assets, the net debt calculation does not provide that measure.

There are only two categories of assets in the PSA Handbook — financial assets and non-financial assets. Together they comprise all the assets of the organization. If resources meet the definition of an asset, then they must also meet either the definition of a financial asset or a non-financial asset. This separation into two categories of assets facilitates the calculation of net debt.

If endowment investments that are restricted in perpetuity do not meet the definition of financial assets, then by default endowment investments must be non-financial assets.

View C – Endowment investments don't meet the definition of either financial or non-financial assets

Endowment investments do not meet the financial asset definition. But they also do not fit into the non-financial assets definition. They are not normally employed to deliver public sector services, they will not be consumed in the normal course of operations and they are not for sale in the normal course of operations. They do not comprise unused service potential.

If endowment investments don't meet either the definition of financial assets or non-financial assets, what are they?

- Are endowment investments really assets of a GNFPO? Reconsider the answer to Issue 1?
- If they are GNFPO assets but don't meet either of the financial or non-financial assets definitions, are either or both of the financial or non-financial assets definitions wrong? Is there a third category of assets for public sector entities?

The Group's Discussion

The Group was divided on the classification of endowment investments. Some Group members focused on the nature of endowment investments as generally comprising financial assets, as stated in View A. They noted that endowment investments provide income that can be used to discharge liabilities or finance future operations. The fact that the principal is restricted in perpetuity does not change the nature of the endowment investments. Those Group members also indicated that endowment investments do not meet the definition on non-financial assets.

Other Group members expressed concern with endowment investments being recognized as financial assets as they would be seen as reducing net debt, but the principal cannot be used to discharge liabilities or finance future operations. To remove the effect of these perpetually restricted assets from

net debt, these Group members felt that reporting endowments as non-financial assets was appropriate even if they do not strictly meet the non-financial asset definition.

One Group member indicated that perhaps the conclusion on Issue 1 should be revisited. If endowment investments meet neither the financial asset nor non-financial asset definition, then perhaps such endowments are trusts. The Group member indicated that some new thinking is needed for standards on endowments in order to reflect their nature.

A question was raised in relation to the conclusion that endowments are non-financial assets. Would Section PS 3450, *Financial Instruments*, apply to endowment investments if they are classified as non-financial assets? PSAB would have to address this issue in a future project on endowments if the related assets are classified as non-financial.

The Group agreed that Issue 2 should be discussed in conjunction with Issue 3 given that the answer to each issue could have an impact on the net debt measure.

Issue 3 – Where should endowment contributions be recorded?

If endowment investments are assets held under administration in a trust as stated in Issue 1, View B, then they and any related income are excluded from the reporting entity of the GNFPO in accordance with *Government Reporting Entity*, paragraphs PS 1300.40-.46.

If the endowment investments are assets of the GNFPO, as stated in Issue 1, View A, then where is the credit related to the contribution of such resources recognized when they are received or receivable?

In the PSA Handbook, there are only two ways a credit can be recognized — as revenue or as a liability. Under public sector GAAP, direct credits to net assets/liabilities (accumulated surplus/deficit) are not allowed. The net assets/liabilities balance is not defined as an element of financial statements. It is merely a residual, and thus, not a balance to which an amount should be directly credited. In practice, however, PSAB has had to allow some items to be recognized directly in accumulated surplus/deficit as pragmatic compromises.

View A – Endowment contributions are a liability

Proponents of this view focus on the accounting for externally restricted inflows in Section PS 3100, *Restricted Assets and Revenue*. They believe that endowment contributions that are externally restricted in perpetuity should be recognized as an asset and a related liability when received or receivable.

Major restricted contributions, such as endowment contributions, do not usually have a right of recovery for the donor should the restriction not be met. This return requirement would potentially “taint” the contribution for tax purposes. However, organizations are generally faithful to their commitments to fulfil donor restrictions as to do otherwise would be quite detrimental to an organization’s future fundraising potential. Consequently, the obligation to meet the restriction is an onerous burden.

A donor-imposed restriction limits the use of contributed assets; it specifies a use that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and

the purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association. Thus, donor-imposed restrictions do generally create substantive external restrictions for the purposes of Section PS 3100.

View B – Endowment contributions are revenue

Proponents of this view rely on the liability definition set out in Section PS 1000, *Financial Statement Concepts*, but more particularly on the same liability definition, and the explanation and interpretation of that definition in Section PS 3200, *Liabilities*.

The liability recognition allowed for externally restricted inflows in Section PS 3100 is in conflict with the liability definition in the conceptual framework in Section PS 1000 and in the standards level Section PS 3200, which elaborates on the meaning and interpretation of the liability definition. Section PS 3100 was issued before the conceptual framework and Section PS 3200. PSAB recognizes that Section PS 3100 is inconsistent with the liability definition in the framework. Such inconsistencies as this will be addressed by PSAB in accordance with the priorities of its technical agenda.

The liability definition in paragraphs PS 1000.44-.45 and Section PS 3200 don't allow liability recognition of restricted endowment contributions.

The definition of a liability indicates that settlement is expected to result in a sacrifice of economic benefits. An endowment contribution that is restricted in perpetuity would never involve the sacrifice of future economic benefits by the recipient GNFPPO.

An endowment contribution restricted in perpetuity would likely involve a responsibility to maintain the endowment, invest the endowment and manage any related income as specified in the endowment agreement. But these types of obligations are fiduciary in nature rather than financial obligations for the purposes of financial reporting.

Proponents of this view argue that Section PS 3200 includes the liability definition and is a standard with at least equal standing to Section PS 3100. That is, it is not just a definition in the framework but comprises standards-level requirements. Applying the liability definition in Section PS 3200 to the circumstances of endowment contributions is consistent with the conceptual framework, and thus, is a more theoretically supportable approach than using the rules for externally restricted inflows in Section PS 3100.

Even if Section PS 3100 were applied, the endowment principal would never be used for the purpose specified as required in paragraph PS 3100.11. No purpose has been specified. The principal is to be maintained in perpetuity. So such contributions should not be recognized as liabilities under Section PS 3100 either.

Inflows that do not give rise to a liability are by default in the nature of revenue and should be recognized as such. Proponents of this view believe that endowments meet the definition of revenue as they are increases in economic resources and no liability is created through their receipt. Thus, an increase in net assets is created by the inflow, bettering the financial position of the entity.

View C – Endowment contributions should be recorded directly through accumulated surplus

Either View A or View B is theoretically supportable given existing conflicting standards-level guidance in the PSA Handbook on externally restricted inflows. Thus, proponents of View C argue that there is no truly definitive guidance in the PSA Handbook on how to account for the specific circumstances of endowment contributions that must be maintained permanently. Neither revenue nor liability recognition is appropriate to the nature of an endowments restricted in perpetuity.

There are three existing precedents in public sector GAAP at the standards level where an item is reflected directly in accumulated surplus/deficit. Section PS 2120, *Accounting Changes*, requires retroactive restatement when there is a change in accounting policy or a correction of an error in prior period financial statements. In addition, remeasurement gains and losses, and the other comprehensive income portion of the equity pick-up of government business enterprises are both excluded from operating results and reflected solely on the statement of remeasurement gains and losses. They adjust the closing balance of the accumulated remeasurement gains and losses, and therefore, arguably are charged directly to accumulated remeasurement gains and losses, a component of accumulated surplus/deficit.

Alternative sources of GAAP support the recognition of endowment contributions directly in accumulated surplus/deficit. Both Section PS 4210 (applicable only to GNFPOs applying the PS 4200 series) and Section 4410, *Contributions — Revenue Recognition* in Part III of the CPA Canada Handbook – Accounting, indicate that under the deferral method — the method that is most consistent with the requirements of Section PS 3100 — endowment contributions are recognized directly in the net assets of an entity.

The Group's Discussion

Group members were divided on Issue 3, similar to Issue 2. While the majority of Group members agreed during the discussion of Issue 1 that endowment investments restricted in perpetuity are assets of the recipient organization, there was debate around Issue 2 as to whether they were financial or non-financial assets. And the positions taken in relation to Issue 2 had an impact on the positions taken in relation to Issue 3.

Some Group members who felt endowment investments were financial assets tended to agree that the receipt of such contributions gave rise to a liability as described in View A. Group members who felt endowment investments were non-financial assets tended to conclude that contributions received were revenue as set out in View B. These positions were primarily derived from concern over the impact of the recognition of endowment investments on the net debt measure. Thus, Group members taking View A on Issues 2 and 3 — financial asset and liability respectively — argued that these positions were appropriate partially because they negated the effect on net debt of recognizing endowment investments as financial assets. And they further argued that recognizing endowment contributions as revenue when receivable or received distorts the financial performance of the entity. Group members that took View B on Issues 2 and 3 — non-financial assets and revenue respectively — felt that their conclusions were appropriate to the nature of permanently restricted endowment contributions and that this recognition does not distort net debt. They noted that endowment contributions do not create a liability to anyone, and even if they did, they would never be “settled”. One Group member indicated

that presentation could be used to separately report and explain endowment revenue to donors and other users of the financial statements.

In relation to View C, one Group member noted that reflecting such contributions in equity was inappropriate as endowments are part of the business of a GNFPO. Another countered that showing restricted endowment contributions in a separate component of equity is reflective of their nature as permanently restricted. A third Group member noted that if the PSA Handbook is inconclusive on an issue, reference can be made to the GAAP hierarchy in Section PS 1150, *Generally Accepted Accounting Principles*. Such reference would probably lead back to use of the PS 4200 series or, if these are specifically prohibited by legislation or regulation of the jurisdiction, to the comparable private sector standards in, Sections 4410 and Section 4420, *Contributions Receivable* in Part III of the CPA Canada Handbook – Accounting. However, the member also indicated that this approach might be inappropriate as it would defeat the intent of the controlling government's requirement for its GNFPOs to use the PSA Handbook without the PS 4200 series.

Group members felt that their divergent views were reflective of the issues being faced by preparers and auditors in the public sector in relation to endowments. There was some feeling that if both Views A and B for Issues 2 and 3 are defensible then there is a standards-level issue for PSAB to resolve. The need to keep the net debt measure and ensure that the items reflected in it do not impair its meaning was emphasized. Group members indicated that some unique thinking may be needed on accounting for endowments and that this topic should be a priority for PSAB's technical agenda.

Section PS 3450 vs. IFRS 9 vs. ASPE – A Presentation on Financial Instruments

A comparative presentation on the financial instruments standards applied by Canadian entities in the public and private sectors was provided to the Group. The presentation provided highlights of the similarities and differences between Section PS 3450, *Financial Instruments*, IFRS 9 for publicly accountable enterprises, and Section 3856 under accounting standards for private enterprises (ASPE). In particular, it set out how each addresses hedge accounting.

After receiving a similar presentation in December 2015, PSAB asked for this presentation to be used as the basis for consulting with PSAB's senior government constituent groups across Canada. Beginning with a common understanding of various financial instrument standards provides a platform from which PSAB staff can seek to understand the issues that are prompting some senior governments to ask PSAB to consider formal hedging provisions akin to those in IFRS 9.

It was felt that including the presentation on the agenda of the Group would provide a public forum for the presentation and allow PSAB staff to seek input from an expert group of its constituents.

The Group's Discussion

Group members sought and received clarification on various matters during the course of their discussion. The session was interactive and questions were asked and comments made during the presentation:

- One Group member inquired if all three standards required derivatives to be recognized at fair value. PSAB staff indicated that each includes that requirement.
- Another Group member questioned the intent of the consultation — to re-open the entire financial instruments standard or to just consider the addition of a hedge accounting option? PSAB staff clarified that the purpose of the consultation is to get input from stakeholders in order to understand the issues that are prompting some senior governments to ask PSAB for a hedge accounting option within the financial instruments standard. There is some concern that a hedge accounting option might not solve the issues being raised. For example, a hedge accounting option will not resolve the issue of the volatility in net debt that arises when some financial instruments are carried at fair value. However, hedge accounting would add complex effectiveness testing to the standard with the requisite audit of such testing.
- One Group member indicated that hedging is used not just to manage volatility but also for structural investing. For example, there may be a basis point advantage to issuing debt and then using hedging to get a better rate. PSAB staff articulated the distinction between hedging for economic purposes (the mechanism) and hedge accounting (the process for justifying certain financial statement reporting).
- The Group's discussion highlighted definitional differences in what is meant by hedging between treasury groups and accounting groups at many public sector entities.
- One Group member noted that there may be a mismatch in items being reflected at fair value. For example, a derivative that is the hedging instrument may be reflected at fair value, while the debt it is hedging is not. In such cases, the accounting does not reflect the management of the debt. In contrast, the synthetic accounting allowed by former Section PS 2600, *Foreign Currency Translation*, would reflect management intent. The government is managing cash flows, not managing fair values. It was acknowledged that the fair value option could allow the underlying debt to be reflected at fair value too.
- One Group member noted that Section PS 3450 allows for hedge accounting without the effectiveness testing required in the other two standards. Thus, this standard does not separate out ineffective pieces of an arrangement and reflect them in surplus/deficit. Therefore, Section PS 3450 is presented as being less onerous for public sector entities.
- Group members identified the issue faced by public sector entities in getting swaps for the long terms required in the public sector, noting that multiple, shorter swaps are required to achieve some hedging goals.
- One Group member indicated that the risk and cash flow management practices of senior governments need to be better understood by PSAB and considered in the financial instruments standard. For example, some items are never intended to be realized but are held to maturity. They are intended to be realized equally in opposite directions at maturity. The standards should isolate and highlight the real risks. It was suggested that the approach taken by the Governmental Accounting Standards Board, which uses deferred inflow and outflow elements, should be

considered as an option for parking those risks that will not be realized. Such an approach would remove the impact on net debt.

- A couple of Group members noted that some jurisdictions have trouble with the requirement to recognize some financial instruments at fair value. They acknowledged, however, that a hedge accounting option would not resolve this issue. Other Group members countered that organizations following IFRSs adopted fair value measurement for some financial instruments in 2011 and that feedback is relatively neutral.

The presentation was well received by the Group. In summarizing the discussion, the Group expressed some surprise at the degree to which volatility in net debt was an issue. This concern did not come out clearly when the financial instruments project was in progress. PSAB had recognized that remeasurements would impact net debt, given that the current reporting model requires remeasurement gains and losses to be reported separately on the statement of change in net debt. But the concern over the volatility of net debt was not explicitly raised.

The Group felt that the presentation was effective and that its use for cross-country consultation with senior governments is a good idea. Group members indicated that there was a gap between how accountants understand hedge accounting and how the treasury officials see it. So the Group suggested that part of the consultation should include trying to get accounting and treasury officials closer in their understanding of hedge accounting by including both in the audience for presentations.