

# Application of GAAP Hierarchy: Operating Leases, Lessee Accounting Treatment

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## Extract, PSA Discussion Group Report on the Public Meeting – June 7, 2024

In February 2024, PSAB issued the Exposure Draft, “[Narrow-scope Amendment: GAAP Designation of PSA Handbook Appendices](#).” In addition to proposals elevating the generally accepted accounting principles (GAAP) designation of four PSA Handbook appendices, the Exposure Draft included a proposal to delete some text in the last box of the decision tree in [Appendix B](#) to Public Sector Guideline 2 (PSG-2). It contains an outdated cross-reference to Section 3065, *Leases*, in former Part V of the CPA Canada Handbook – Accounting, pre-changeover accounting standards. Part V has since been removed from that Handbook. PSAB explained that this deletion means that, because the PSA Handbook contains no pronouncements related to operating leases, entities would have to apply the GAAP hierarchy<sup>6</sup> in [Section PS 1150, Generally Accepted Accounting Principles](#), to determine the appropriate accounting for operating leases by lessees.

Responses to the Exposure Draft, “[Narrow-scope Amendment: GAAP Designation of PSA Handbook Appendices](#),” agreed with removal of the outdated cross-reference but had various suggestions for what should replace it or what other approaches PSAB should consider. That is, many felt that merely leaving entities to apply the GAAP hierarchy to draft an entity-developed accounting policy<sup>7</sup> was insufficient and would lead to inconsistent accounting treatment of operating leases by lessees across public sector entities using Public Sector Accounting Standards (PSAS). The submission discussed the options raised by respondents for consideration by the Group. The options were as follows:

- [View A](#): PSAB should add to PSG-2 [Appendix B](#) decision tree a specific cross-reference to [Section PS 1150](#) GAAP hierarchy to prompt its use for drafting a new accounting policy on lessee accounting for operating leases.
- [View B](#): PSAB should add to PSG-2 Appendix B decision tree a specific cross-reference to International Public Sector Accounting Standards (IPSAS) 13, *Leases*, to allow its use for lessee accounting for operating leases.
- [View C](#): PSAB should add to PSG-2 Appendix B decision tree a specific cross-reference to [Section 3065, Leases](#), in Part II of the Handbook – Accounting Standards for Private Enterprises (ASPE) to allow its use for lessee accounting for operating leases.

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<sup>6</sup> The GAAP hierarchy is set out in [paragraph PS 1150.03\(d\)](#). It sets out the levels of primary sources of GAAP in descending order of authority, with standards having the most authority, followed by Public Sector Guidelines and then illustrative material. Application guidance appendices are the same level of GAAP as the standard (or guideline) to which they are integral.

<sup>7</sup> Entity-developed accounting policies are defined in [paragraph PS 1150.03\(b\)](#).

- View D: Section PS 1150 requires use of IPSAS 43, *Leases*, for drafting a new accounting policy for lessee accounting for operating leases.
- View E: PSAB should add to PSG-2 Appendix B decision tree to show how GAAP hierarchy applies in drafting an entity-developed accounting policy for operating leases by lessees.
- View F: PSAB should explain in the Basis for Conclusions why the IPSAS 43 lessee model is inconsistent with the *Conceptual Framework for Financial Reporting in the Public Sector* and PSAS, and so cannot be used for drafting a new accounting policy on lessee accounting for operating leases.

Group members weighed in on the merits of the six options. One distinction made was that Views B to F are very directive, while View A emphasizes professional judgment through applying the guidance in [Section PS 1150](#). Some Group members acknowledged View A as more consistent with the principles-based standards in the PSA Handbook. And one Group member noted that inherently allowing application of a GAAP hierarchy carries the risk of resulting in diverse accounting practices when PSAS are silent. However, others expressed concern about the lack of consistency in lessee accounting for operating leases that might arise if View A were to be adopted by PSAB.

Several Group members noted that a change in practice, perhaps significant for some entities, in lessee accounting for operating leases – such as would arise through use of IPSAS 43 – may not be appropriate until PSAB is able to address leases in its technical agenda. The Group indicated that the least disruptive approach to this issue has merit.

The points raised by Group members in relation to the various views were as follows:

**View A: Cross-reference to GAAP Hierarchy**

- Respects the GAAP hierarchy.
- Has no cross-reference to other reporting frameworks, so PSA Handbook stands on its own.
- Is consistent with principles-based standard setting in the PSA Handbook.
- Allows for application of professional judgment.
- May result in a change in practice for some entities and inconsistent or diverse accounting policies across entities for lessee accounting for operating leases.
- May result in a significant change in accounting policy for some entities, while no change for others; it will depend on which alternative source they rely on to draft their accounting policy per [paragraph PS 1150.19](#).
- Can look within PSA Handbook to draft an accounting policy using the element definitions, for example.

**View B: Cross-reference to IPSAS 13, Leases**

- Is prescriptive; so, this approach will reduce disparity in lessee accounting for operating leases.
- Respects the GAAP hierarchy, as the accounting in IPSAS 13 for operating leases is consistent with the Canadian Conceptual Framework and the primary sources of Canadian GAAP.
- Respects PSAB's international strategy.
- IPSAS 13 will be withdrawn from the IPSAS soon; if it is referenced, PSAB would need to request it remain available to Canadian users.
- IPSAS 13 lessee accounting for operating leases is consistent with existing practice in Section 3065 of former Part V; so, no change in practice for public sector entities applying PSG-2.
- Includes a specific cross-reference to another financial reporting framework so the PSA Handbook does not stand on its own.

**View C: Cross-reference to ASPE Section 3065**

- It is prescriptive; so, this approach will reduce disparity in lessee accounting for operating leases.
- Respects the GAAP hierarchy as the accounting in ASPE Section 3065 for operating leases is consistent with the Canadian Conceptual Framework and the primary sources of Canadian GAAP.
- Inconsistent with PSAB's international strategy.
- ASPE Section 3065 lessee accounting for operating leases is consistent with existing practice in Section 3065 of former Part V; so, no change in practice for public sector entities applying PSG-2.
- Includes a specific cross-reference to another financial reporting framework so the PSA Handbook does not stand on its own.

**View D: Section PS 1150 Requires Use of IPSAS 43 for New Accounting Policy**

- Does not respect the GAAP hierarchy. The accounting model for lessees in IPSAS 43 is a “right of use” model, which is different than the “risks and rewards incremental to ownership” model in PSG-2. Thus IPSAS 43 is inconsistent with both the Conceptual Framework and the primary sources of GAAP in Canada.
- Respects PSAB's international strategy.
- Would result in a change in practice for all public sector entities for lessee accounting for operating leases.
- Is a very narrow interpretation of Section PS 1150, which for pragmatic reasons encourages IPSAS as the first alternative source to consider when PSAS are silent. As future PSAS will leverage IPSAS principles when appropriate for Canada and if the principles are consistent with the Canadian Conceptual Framework, it is a practical choice to base entity-developed accounting policies on an IPSAS when one is available and appropriate in accordance with the requirements of [paragraph PS 1150.05](#).

**View E: Expand PSG-2 Appendix B Decision Tree to Illustrate How to Apply GAAP Hierarchy for Lessee Accounting for Operating Leases**

- Is prescriptive; so, this approach will reduce disparity in lessee accounting for operating leases.
- Would set a precedent for PSAB having to specifically indicate how the GAAP hierarchy would apply in other specific scenarios, which reduces the application of professional judgment and may be interpreted as a move away from principles-based standard setting.
- Implies there is only one answer when applying the GAAP hierarchy. That is, that professional judgment is not involved.

**View F: Explain in Basis for Conclusions that IPSAS 43 Cannot Be Used for New Accounting Policy**

The Group agreed that View F was not a viable option. Basis for Conclusions documents are non-authoritative and are not by definition expected to include application guidance for standards or guidelines. Also, there is a risk that such a conclusion would set a precedent and restrict the ability of entities to apply professional judgment in using the GAAP hierarchy.

One Group member suggested a View G. View G would include in PSG-2 the limited guidance on lessee operating lease accounting from Section 3065 of former Part V and update [Appendix B](#) accordingly. This would be an interim step until PSAB can add a project on leases to its technical agenda. Although new text would be added to PSG-2, no change in practice would be expected given the added approach is the same as what would result from following the deleted outdated cross-reference to Section 3065 in former Part V.

The Chair noted that Group members were initially favouring View A, View B, and View C in their comments, trying to provide appropriate direction that balanced the use of professional judgment with reducing the potential for diversity in accounting. Consistent application of PSAB's international strategy and the GAAP hierarchy were also factors considered by Group members when providing their perspectives. Some felt that implementing a right of use model for lessee accounting through a narrow-scope amendment to a guideline would not be appropriate.

Ultimately, the Group reconsidered all the views after hearing View G and agreed that this was the best interim solution for PSAB until the Board can add a leases project to its technical agenda.