

Purchased Intangibles — Basis for Conclusions

PSG-8

Foreword

CPA Canada Public Sector Accounting Handbook Revisions Release No. 51, issued in November 2020, contained narrow scope amendments to FINANCIAL STATEMENT CONCEPTS, Section PS 1000, and FINANCIAL STATEMENT PRESENTATION, Section PS 1201, and new PUBLIC SECTOR GUIDELINE PSG-8, Purchased Intangibles, to allow recognition of purchased intangibles in financial statements.

The primary objective of a Basis for Conclusions document is to set out how the Public Sector Accounting Board (PSAB) reached its conclusions. As well, it sets out significant matters arising from comments received in response to the proposals exposed and indicates how PSAB has dealt with the issues raised.

These documents are intended to assist financial statement users, preparers, auditors and other parties interested in public sector financial reporting in understanding the rationale followed by PSAB when developing standards.

This document has been prepared by staff of PSAB. It does not form part of the CPA Canada Public Sector Accounting (PSA) Handbook nor is it part of public sector generally accepted accounting principles (GAAP). Basis for Conclusions documents also do not include any guidance on the application of the relevant Section or Guideline.

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BACKGROUND

- Recognition prohibitions exist in the PSA Handbook. For pragmatic reasons, they disallow recognizing certain items as assets in financial statements. PSAB has elected to remove one of those prohibitions to allow recognition of intangibles purchased through an exchange transaction ("purchased intangibles") in financial statements.
- Prior to these amendments, the PSA Handbook excluded from recognition as assets in financial statements:
 - all intangibles;
 - all works of art and historical treasures; and
 - inherited Crown lands and inherited natural resources.

Purchased natural resources and purchased Crown lands are already allowed to be recognized as assets in financial statements if they meet the definition of an asset set out in FINANCIAL STATEMENT CONCEPTS, paragraph PS 1000.35, and elaborated on in ASSETS, Section PS 3210, as well as the general recognition criteria in paragraphs PS 1000.55-.56. Purchased intangibles are now allowed to be recognized on the same basis.
- A standard on accounting for intangibles does not currently exist in the PSA Handbook. A minority of Exposure Draft respondents asked PSAB to conduct a full project on accounting for intangibles before opening the door to recognition of any intangibles. The view expressed was that guidance is necessary for entities to consistently account for and report their intangibles.
- PSAB acknowledges the gap in public sector accounting standards. The Board will address it as resources become available and the topic is identified as a priority by stakeholders. PSG-8 is interim guidance to allow recognition of intangibles purchased through an exchange transaction. However, specific guidance on recognition, measurement, presentation (including disclosure) of intangibles would be the subject of a future project. As any of the items excluded from recognition in the PSA Handbook become priority topics for stakeholders, they become candidates for PSAB's technical agenda.

OBJECTIVE

- 5 A key objective of the Guideline and the related amendments to standards is to remove on a timely basis a barrier to fair presentation in the financial statements of some public sector entities. Indigenous governments asked PSAB to reconsider the prohibition on recognizing purchased intangibles. Writing off such acquisitions is a material issue for some Indigenous governments, for example, in relation to some commercial fishing licences. It affects the representation of their financial results and their financial position, especially if the acquisitions are financed with debt. PSAB also received feedback that some government organizations have had to write off the cost of intangibles acquired in exchange transactions and would prefer asset recognition of purchased intangibles.
- 6 Relocating the recognition prohibitions from the conceptual framework to GAAP, as contemplated in PSAB's Concepts Underlying Financial Performance project, would not accomplish this objective.

PURPOSE AND SCOPE

- 7 Intangibles that are developed or inherited in right of the Crown would continue to be excluded from recognition as assets in financial statements. Recognition, measurement and disclosure of these intangibles is expected to be more complex than for intangibles purchased through an exchange transaction. These issues require specific guidance from PSAB in a future project on accounting for intangibles.
- 8 Exposure Draft respondents asked PSAB to include a definition of purchased intangibles in the guidance. PSAB agreed that this would clarify the scope of the items now allowed to be recognized. A definition substantially based on that for intangible assets in Intangible Assets, IPSAS 31, was included in PSG-8.
- 9 Respondents also suggested that the Board include within GAAP some of the text from the Exposure Draft's Basis for Conclusions, including:
- (a) The requirement for the purchase to be through an exchange transaction. The Board agreed and included in PSG-8 this requirement and a reference to the definition of an exchange transaction in REVENUE, Section PS 3400.
 - (b) Links to existing guidance in the PSA Handbook where intangibles are addressed. For example:
 - (i) software is identified as a tangible capital asset in TANGIBLE CAPITAL ASSETS, Section PS 3150.
 - (ii) purchase premiums arising on acquisition of a governmental unit are addressed in ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510.
 - (iii) purchase premiums arising on acquisition of a government business enterprise are addressed in INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070.
- PSAB agreed and included these references in PSG-8.
- 10 Respondents also asked that PSAB include guidance on whether transferred intangibles or intangibles acquired through inter-entity transactions would be considered purchased and thus allowed to be recognized. The Board clarified in PSG-8 that intangibles acquired through a transfer, 1 contribution or inter-entity transaction, 2 are not purchased intangibles.
- 11 In response to comments on the Exposure Draft, PSAB also confirmed that government not-for-profit organizations using the PS 4200 series of standards would account for purchased intangibles in accordance with CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section PS 4230.

RECOGNITION, MEASUREMENT AND PRESENTATION

- 12 Several respondents to the Exposure Draft suggested further guidance could be provided without issuing a full intangibles standard. Basic guidance was suggested for:
- (a) timing and method of recognition, including amortization;
 - (b) initial and subsequent measurement; and
 - (c) presentation (including disclosure).
- PSAB debated the merits of four draft guidelines providing increasing levels of recognition, measurement and presentation guidance. Ultimately, the Board concluded that to be consistent with the identified scope of the project as a narrow scope amendment, the most it could do at this time was clarify the scope of what it had intended to allow recognition of, and set transitional provisions and an effective date. To go into further detail would in effect add a full intangibles project to the Board's technical agenda without going through its traditional project priority survey process with stakeholders.
- 13 Some Exposure Draft respondents indicated that there would be inconsistency in application if the door to recognition of purchased intangibles was opened without accompanying detailed accounting guidance. While the Board acknowledged that there would be some diversity in practice, it concluded that reference to the conceptual framework and GAAP hierarchy would provide boundaries to ensure a measure of consistency. Further, purchased intangibles are acquired through an exchange transaction in which a negotiated price is paid. So, initial measurement of these intangibles is possible and their recognition appropriate if they meet the definition of an asset and the general recognition criteria.
- 14 A few respondents also suggested that PSAB should provide guidance on the implications of opening the door to recognition of purchased intangibles for accounting for software and cloud computing arrangements. The Board confirmed that for now software would continue to be accounted for in accordance with Section PS 3150. The accounting issues related to cloud computing arrangements were deferred for future consideration.

TRANSITIONAL PROVISIONS AND EFFECTIVE DATE

- 15 A number of respondents indicated that the proposed effective date of April 1, 2021, would be onerous even for prospective application of the new requirement. PSAB initially agreed to push back the date of application by one year. Following PSAB's decision in response to COVID-19 to defer the effective date of all new standards by one year, the Board subsequently chose to require the recognition of purchased intangibles that are assets effective for fiscal years beginning on or after April 1, 2023.
- 16 Some respondents requested modified prospective application (i.e., recognizing only new purchased intangibles). Others requested more transitional guidance or relief, expecting the task of recognizing purchased intangibles to be burdensome. PSAB considered various options, including recognition of only new purchased intangibles. The Board ultimately concluded that the choice of retroactive or prospective application was permissive and thus, provided sufficient flexibility.

DUE PROCESS

- 17 A couple of respondents expressed concern that the materiality of purchased intangibles for some entities would disqualify the Exposure Draft proposals from being narrow scope amendments. In PSAB's due process, narrow scope amendments do affect practice and may, therefore, involve change(s) in principle(s). They are identified as narrow in scope because they are not a significant re-write of an existing standard or proposals for a new standard. The materiality of the impact of the change is not a consideration in determining whether proposals are narrow scope amendments. However, materiality may be considered in determining the length of the transition period. Based on input from Exposure Draft respondents, the Board concluded that one reason for an extended transition period is the anticipated materiality of purchased intangibles to some public sector entities.

Footnotes

1. Defined in GOVERNMENT TRANSFERS, paragraph PS 3410.04.
2. Defined in INTER-ENTITY TRANSACTIONS, paragraph PS 3420.04(g).

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