SECTION PS 1000
financial statement concepts

FOR FUTURE UPDATES TO THIS SECTION, see new CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING IN THE PUBLIC SECTOR

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PURPOSE AND SCOPE

.01 This Section describes the concepts underlying the development and use of accounting principles in government financial statements. Such financial statements are designed to meet the common information needs of external users of financial information about a government.

.02 "Financial statements" refers to the summary financial statements published by a government that report on the financial position and changes in financial position of the government reporting entity. Financial statements include the notes and schedules supporting the statements. "Government" refers to the elected and appointed policy-makers and administrators who together perform the executive function and are the preparers of financial statements.

.03 This Section is to be used by preparers and auditors of financial statements in exercising their professional judgment as to the application of generally accepted accounting principles and in establishing accounting policies in areas in which accounting principles are developing.

.04 This Section does not establish standards for particular measurement or disclosure issues. Nothing in the Section overrides any specific standard in another Section of the CPA Canada Public Sector Accounting Handbook. The Public Sector Accounting Board (the Board) will review any inconsistency between this Section and another Section when that other Section is re-examined.

.05 Financial reporting and accounting standards are evolutionary and are revised to reflect changes in conditions. Standards are the concepts, conventions and postulates that provide principles to measure, recognize, present and disclose the financial information considered necessary for accountability and useful for decision making. In government standards, the unique characteristics of government (see Appendix A to FINANCIAL STATEMENT OBJECTIVES, Section PS 1100) are a primary consideration in setting the parameters of the government reporting model.

.06 Standards generally do not prescribe format, ordering of financial statements or financial statement elements, or terminology except as required to meet the measurement and presentation requirements of the standards. Standards do, however, specify what measure(s) must be reported on a statement, and the calculation of those measures may demand a certain ordering of the financial statement elements reported. In all other aspects, preparers of government financial statements use professional judgment to design financial statements tailored to their users' needs.

CONTEXT OF GOVERNMENT FINANCIAL STATEMENTS

.07 *A government financial report should present information that is useful in evaluating the government's financial condition at the end of the accounting period and its financial performance during the accounting period. Government financial statements are a fundamental component of a government financial report.* [APRIL 2005]

.08 The financial position of a government as measured in the financial statements is only one factor in determining the financial condition of a government. Financial condition is a broad, complex concept with both short- and long-term implications that describes a government's financial health in the context of the overall economic and financial environment. Nevertheless, financial statements provide information that is critical to evaluating the financial condition of the government, and they form the cornerstone of a government financial report.

.09 The changes in the government's financial position presented in the financial statements are essential factors in assessing the financial performance of the government in the accounting period. They are, however, not the sole measures of government financial performance in the period. Additional financial performance information that draws on information external to the financial statements supplements and adds further depth to the picture of financial performance illustrated in the financial statements.

.10 The complex nature of government, its myriad of objectives and its public accountability requires multi-faceted reporting. Accordingly, total government reporting envisions a multidimensional accountability report comprising: a financial report that includes government financial statements; other information about a government's financial condition, and supplementary financial performance information; as well as non-financial information.

.11 All governments in Canada publish financial statements that display their financial position and the changes in financial position in the period. These financial statements are general purpose statements that serve, to the extent possible, the needs of a variety of users. Such statements are commonly required by law, audited and issued annually and, while most often addressed to legislatures or councils, are available to all interested parties.

.12 Financial statements cannot be expected to fulfill all of the users' needs served by a government's financial reporting system. Governments produce many kinds of financial reports in addition to financial statements. For example, there are reports prepared by individual entities to comply with legislation; there are reports to measure and report on the performance of individual funds, programs and activities; and there are special purpose reports designed to meet particular needs of specific users. In addition, governments set out their fiscal plan in budgets and estimates of expenses or expenditures. Some information, such as related performance information and narrative explanations, can only be provided in other financial reports or as supplementary information to the financial statements themselves. Thus, certain information is better provided, or can only be provided, by financial reports other than financial statements.

.13 Nevertheless, financial statements are a central feature of government financial reporting. They serve as a means by which a government provides an accounting of its administration of public financial affairs and resources. These financial statements are a principal means of communicating financial information to those not involved in the government's financial administration and present aggregated information capable of integration with other financial statements, schedules and reports provided by the government. Because of this key role, the objectives of government financial statements (see FINANCIAL STATEMENT OBJECTIVES, Section PS 1100) are a significant factor in the selection of accounting policies used in government financial reporting and in the determination of information required from the accounting system.

USERS AND USER INFORMATION NEEDS

.14 Government financial statements serve the interests of a variety of users: the public, legislators, councillors, investors, analysts and other governments.

.15 Legislatures, councils and governments are accountable to the public, who provide the revenues and resources necessary for government operations, who receive government services and who are the beneficial owners of the public money and property for which legislatures, councils and governments are responsible. The public is comprised of groups with a variety of interests and views.

.16 As elected representatives of the public, legislators and councillors are primary users of government financial statements. They grant authority to the government to administer public resources and financial affairs, and hold the government accountable for its financial administration.

.17 Investors in government securities and enterprises provide financial resources. Government has an interest in providing information useful to them in evaluating its ability to finance its activities and to meet its liabilities and contractual obligations. Economic and financial analysts serve legislators and councillors, investors and other interested parties. They use financial statements and other information to analyze and evaluate financial issues.

.18 Users are interested in the state of a government's finances, its financial viability both in the short and long term, its revenues and financing sources, the allocation and use of its economic resources, the nature and extent of its economic activities and the quality of its financial management. In particular, government financial statements need to report the information required by users to help them make assessments and judgments concerning government financial operations and management.

.19 More specifically, users look to financial statements to provide information about:

(a) the sources and types of government revenues;

(b) the allocation and use of economic resources;

(c) the cost of goods and services provided in the accounting period;
(d) the extent to which the costs of the period were met by the revenues of the period;
(e) the government's financial position;
(f) the stock, allocation and use of non-financial resources;
(g) the extent to which revenues were sufficient to meet expenditures;
(h) how the government financed its activities and how it met its cash requirements;
(i) actual results of activities of the period in comparison with those originally planned and those of past periods; and
(j) whether public economic resources were managed in accordance with legislative authorities.

.20 Information in financial statements may be used for a number of diverse purposes depending on the interests of the users. For example, information presented in the financial statements, when used with other information, is useful in gaining an understanding of and assessing:

(a) a government's ability to meet its financial obligations, both short- and long-term;
(b) a government's ability to maintain the level and quality of its services and to finance new programs;
(c) future tax and other revenue requirements;
(d) government spending priorities;
(e) the impact of government economic activities on the economy; and
(f) the performance of government in managing the economic resources for which it is responsible.

FINANCIAL STATEMENT OBJECTIVES

.21 The information needed to aid understanding and assessments of government financial operations and to promote accountability extends beyond reporting surpluses and deficits. A government's financial statements must provide information that describes liabilities and financial assets, its non-financial assets that are available for use in providing future services, the cost of using its economic resources in the delivery of services, as well as information about investing and financing activities and potential assets and liabilities. Further, this information needs to highlight measures (for example, net debt and net economic resources) that help users assess whether the government's financial position has improved or deteriorated and explain the changes in financial position. The information reported in financial statements must also reflect the full nature and extent of the government's resources, obligations and financial affairs. The objectives of government financial statements are outlined in FINANCIAL STATEMENT OBJECTIVES, Section PS 1100, and are consistent with the financial statement concepts of this Section.

BENEFIT VERSUS COST CONSTRAINT

.22 The benefits expected to arise from providing information in financial statements should exceed the cost of doing so. This constraint also applies to the development of accounting standards by the Board. It is also a consideration when preparing financial statements in accordance with those standards (for example, in considering disclosure of information beyond that required by the standards). The Board recognizes that the benefits and costs may accrue to different parties and that the evaluation of the nature and amount of benefits and costs is substantially a judgmental process.

QUALITATIVE CHARACTERISTICS

.23 The function of financial statements is the communication of information to users. To fulfill this function effectively, the information must be relevant and reliable, and communicated in a manner that best facilitates its use.

.24 *Financial statements should communicate information that is relevant to the needs of those for whom the statements are prepared, reliable, comparable, understandable and clearly presented in a manner that maximizes its usefulness.* [APRIL 2005]

.25 Financial statements provide evidence of accountability and report information required by users to help them make assessments and judgments concerning government financial operations and management. To adequately serve these needs in a manner that maximizes its usefulness, information in financial statements must possess certain basic qualities. These qualities are essential to the utility of government financial statements. The information required to meet the objectives of government financial statements needs to embody these essential characteristics.

Relevance

.26 For the information provided in financial statements to be useful, it must be relevant to the decisions made by users and for assessing accountability. Information is relevant by its nature when it can influence the decisions of users by helping them evaluate the financial impact or potential financial impact of past, present or future transactions and events or confirm, or correct, previous evaluations. For the information in government financial statements to be relevant to the needs of users, it must also be of a nature, and presented in a manner, that helps users assess the accountability of the government for its administration of public resources and financial affairs.

.27 Financial statements are not intended to provide all of the information necessary to users for decision making or for assessing government accountability. Nevertheless, they provide a fundamental component of the information needed for such purposes.

.28 Relevance is achieved through information that has predictive, feedback and accountability value, and is timely.

(a) **Predictive value and feedback value**

Information that helps users to predict a government's future financial results and cash flows has predictive value. Although the data provided in financial statements will not normally be a prediction in itself, it may be useful in making predictions. The predictive value of the statement of operations, for example, is enhanced if abnormal items are separately disclosed. Information that confirms or corrects previous predictions has feedback value. Information often has both predictive value and feedback value.

(b) **Accountability value**

Information that helps users assess a government's stewardship of the resources entrusted to it, including how resources have been applied and consumed in providing services, has accountability value. Information in government financial statements must be presented in a manner that assists in discharging this accountability. To provide accountability value, financial statements should reflect the nature and dimensions of financial position and performance that are characteristic of and appropriate to the unique nature of government. Accountability value is enhanced when financial statements identify the financial objectives and targets normally established by formal process and measure actual achievements against those financial objectives and targets. The accountability value of the information in the financial statements is also enhanced when the financial and non-financial performance information disclosed elsewhere in the Public Accounts, annual report or other report of the government can be related to the information in financial statements.

(c) **Timeliness**

Information should be timely. Financial statements issued long after the end of the fiscal period are of historical interest only. For information to be useful for decision making and accountability, the decision maker or stakeholder must receive it before it loses its capacity to influence decisions. The usefulness of information for decision making and assessing accountability declines as time elapses.

Reliability

.29 Information should be reliable. Inaccurate, inappropriate or incomplete information, or information that is biased or does not faithfully represent what it purports to represent, will inhibit rather than enhance understanding, evaluation and decision making by users and adversely affect the accountability provided by the financial statements to stakeholders. Reliable information has the following characteristics.

(a) **Representational faithfulness**

Representational faithfulness is achieved when transactions and events affecting the entity are presented in financial statements in a manner that is in agreement with the actual underlying transactions and events. Thus, transactions and events are accounted for and presented in a manner that conveys their substance rather than necessarily their legal or other form. The substance of transactions and events may not always be consistent with that apparent from their legal or other form. To determine the substance of a transaction or event, it may be necessary to consider a group of related knowledgeable and independent observers would concur that it is in agreement with the actual underlying transaction or event with a reasonable degree of precision.

(b) **Completeness**

Information is complete when none of the data necessary to achieve representational faithfulness is lacking. Completeness of disclosure means providing sufficient information about transactions, circumstances or events of such size, nature or incidence that their disclosure is necessary to understand the government's finances. In assessing the degree of completeness of the information provided in financial statements, the benefit / cost constraint in paragraph PS 1000.22 and the qualitative characteristics trade-off described in paragraph PS 1000.32 would be considered. Reliability implies completeness of information, at least within the bounds of what is material and feasible, considering the cost. An omission can rob information of its claim to neutrality if the omission is material and is intended to induce or inhibit some particular mode of behaviour.

(c) **Neutrality**

Information is neutral when it is free from bias that would lead users towards making decisions that are influenced by the way the information is measured or presented. Bias in measurement occurs when a measure tends to consistently overstate or understate the items being measured. In the selection of accounting principles, bias may occur when the selection is made with the interests of particular users or with particular economic or political objectives in mind. Financial statements that do not include everything necessary for faithful representation of transactions and events affecting the entity would be incomplete and, therefore, potentially biased.

Neutrality does not mean "without purpose", nor does it mean that accounting should be without influence on human behaviour. Accounting information cannot avoid affecting behaviour, nor should it. It is, above all, the predetermination of a desired result, and the consequential selection of information to induce that result, that negates neutrality in accounting. To be neutral, accounting information must report economic activity as faithfully as possible, without colouring the image it communicates for the purpose of influencing behaviour in some particular direction.

(d) **Conservatism**

The application of conservatism in making judgments under conditions of uncertainty affects the neutrality of financial statements in an acceptable manner. When uncertainty exists, estimates of a conservative nature attempt to ensure that assets, revenues and gains are not overstated and, conversely, that liabilities, expenses and losses are not understated. Conservatism does not, however, encompass the deliberate understatement of assets and revenues or the deliberate overstatement of liabilities and expenses.

(e) **Verifiability**
The financial statement representation of a transaction or event is verifiable if knowledgeable and independent observers would concur that it is in agreement with the actual underlying transaction or event with a reasonable degree of precision. Verifiability focuses on the correct application of a basis of measurement rather than its appropriateness.

Comparability

.30 Comparability is a characteristic of the relationship between two pieces of information rather than of a particular piece of information by itself. It enables users to identify similarities in and differences between the information provided by two sets of financial statements. Uniformity in application of principles is important when comparing the financial statements of two different entities. Consistency in application is important when comparing the financial statements of the same entity over two periods or at two different points in time. Consistency helps prevent misconceptions that might result from the application of different accounting policies in different periods. When a change in accounting policy is deemed to be appropriate, disclosure of the effects of the change is necessary to maintain comparability.

Understandability and clear presentation

.31 Information should be understandable and clearly presented. Excessive detail, vague or overly technical descriptions, and complex presentation formats result in confusion and misinterpretation. Users need information presented clearly and simply. For the information provided in financial statements to be useful, it must be capable of being understood by users. Users are assumed to have a reasonable understanding of economic activities and accounting, together with a willingness to study the information with reasonable diligence.

Qualitative characteristics trade-off

.32 In practice, a trade-off between qualitative characteristics is often necessary, particularly between relevance and reliability. For example, there is often a trade-off between the timeliness of producing financial statements and the reliability of the information reported in the statements. There may also be a trade-off between the accountability value of information and the level of detail appropriate to the financial statements, as well as the cost of providing it. As described in paragraph PS 1000.12, some information may be better provided by other reports in the government's reporting system. Generally, the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

ELEMENTS OF FINANCIAL STATEMENTS

.33 Elements of financial statements are the basic categories of items portrayed therein in order to meet the objectives of financial statements. There are two types of elements: those that describe the economic (financial and non-financial) resources, obligations and accumulated surplus or deficit of a government at a point in time, and those that describe changes in economic resources, obligations and accumulated surplus or deficit over a period of time. Notes to financial statements, which are useful for the purpose of clarification or further explanation of the items in financial statements, while an integral part of financial statements, are not considered to be an element.

.34 The elements of government financial statements include: assets (both financial and non-financial), liabilities, revenues, and expenses. Revenues and expenses and, therefore, operating results for an accounting period, result only from changes in assets and liabilities. Operating results, when taken together with amounts reported in the statement of remeasurement gains and losses, account for the change in net economic resources for an entity for a period and, except in specific circumstances, articulate that change (economic, financial and non-financial resources are defined in FINANCIAL STATEMENT OBJECTIVES, Section PS 1100). Specific circumstances affecting net economic resources that are excluded from operations are identified in individual Sections of the PSA Handbook, for example ACCOUNTING CHANGES, Section PS 2120. Definitions of the elements that together comprise operating results, revenues and expenses, are derived from the definitions of assets and liabilities.

.35 **Assets** are economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.

.36 Assets have three essential characteristics:

(a) they embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows;

(b) the public sector entity can control the economic resource and access to the future economic benefits; and

(c) the transaction or event giving rise to the public sector entity's control has already occurred.

.37 An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph. Thus, for example, an item does not qualify as an asset of a government if the item involves:

(a) no future economic benefit;

(b) future economic benefit, but the government cannot obtain it; or

(c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred.

.39 **Financial assets** are assets that could be used to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations.

.40 A financial asset is any asset that is:

(a) cash;

(b) a realizable asset that is convertible to cash;

(c) a contractual right to receive cash or another financial asset from another party;

(d) a contractual right to exchange financial instruments with another party under conditions that are potentially favourable to the government;

(e) an equity instrument of another entity;

(f) an investment in a government business enterprise or business partnership;

(g) a financial claim on an outside organization or individual; or

(h) an inventory or item for sale that meets the criteria in FINANCIAL STATEMENT PRESENTATION, paragraph PS 1201.055.

.41 Non-financial assets include tangible capital assets, and other assets such as prepaid expenses and inventories of supplies.

.42 **Non-financial assets** are acquired, constructed or developed assets that do not normally provide resources to discharge existing liabilities, but instead:

(a) are normally employed to deliver government services;

(b) may be consumed in the normal course of operations; and

(c) are not for sale in the normal course of operations.

.43 **Tangible capital assets** are non-financial assets 1 having physical substance that:

(a) are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets;

(b) have useful economic lives extending beyond an accounting period;

(c) are to be used on a continuing basis; and

(d) are not for sale in the ordinary course of operations.

.44 **Liabilities** are present obligations of a government to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.

.45 Liabilities have three essential characteristics:

(a) they embody a duty or responsibility to others, leaving a government little or no discretion to avoid settlement of the obligation;

(b) the duty or responsibility to others entails settlement by future transfer or use of assets, provision of goods or services, or other form of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand; and

(c) the transactions or events obligating the government have already occurred.

.46 **Revenues**, including gains, are increases in economic resources, either by way of increases of assets or decreases of liabilities, resulting from the operations, transactions and events of the accounting period.

.47 Revenues, other than gains, can arise from: taxation; the sale of goods; the rendering of services; the use by others of government economic resources yielding rent, interest, royalties or dividends; or receiving contributions such as grants, donations and bequests. Revenues do not include borrowings, such as proceeds from debt issues or transfers from other governmental units in the government reporting entity or amounts collected on behalf of others.

.48 Gains can arise from peripheral or incidental transactions and events affecting a government. Such transactions and events include the disposition of assets purchased for use and not for resale, and the liquidation or refinancing of debt.

.49 **Expenses**, including losses, are decreases in economic resources, either by way of decreases in assets or increases in liabilities, resulting from the operations, transactions and events of the accounting period.

.50 Expenses include the cost of economic resources consumed in and identifiable with the operations of the accounting period. For example, the cost of tangible capital assets is amortized to expenses as the assets are used in delivering government programs (see TANGIBLE CAPITAL ASSETS, Section PS 3150). Expenses do not include debt repayments or transfers to other governmental units in the government reporting entity.

.51 Losses can arise from peripheral or incidental transactions and events affecting a government. Such transactions and events include the disposition of assets purchased for use and not for resale, and the liquidation or refinancing of debt.

RECOGNITION

.52 Recognition is the process of including an item in the financial statements of an entity. Recognition consists of the addition of the amount involved into item totals on a financial statement together with a narrative description of the item (for example, receivables, user fees, grants) in a statement. Similar items may be grouped together in the financial statements for the purpose of presentation.

.53 Recognition means inclusion of an item within one or more individual statements and does not mean disclosure in the notes to the financial statements. Notes either provide further details about items recognized in the financial statements, or provide information about items that do not meet the criteria for recognition and thus are not recognized in the financial statements.

.54 The recognition criteria below provide general guidance on when an item is recognized in the financial statements. Whether a particular item is recognized or not will require the application of professional judgment in considering whether the specific circumstances meet the recognition criteria.

.55 The recognition criteria are as follows:

(a) the item has an appropriate basis of measurement, and a reasonable estimate can be made of the amount involved; and

(b) for an item that involves obtaining or giving up future economic benefits, it is expected that such benefits will be obtained or given up.

.56 It is possible that an item will meet the definition of an element but still not be recognized in the financial statements because it is not expected that future economic benefits will be obtained or given up or because a reasonable estimate cannot be made of the amount involved. It may be appropriate to provide information about items that do not meet the recognition criteria in notes to the financial statements. "Expected" is used with its usual general meaning and refers to that which can reasonably be anticipated, contemplated or believed on the basis of available evidence or logic but is neither certain nor proved. The use of the word in the recognition criteria is intended to acknowledge that economic activities occur in an environment characterized by uncertainty. It is not intended to accommodate the recognition of items that do not meet the definition of one of the elements of financial statements. By implication, recognition would, therefore, not be appropriate without the occurrence of a past transaction or economic event that gives rise to an asset, liability, revenue or expense as defined in this Section.

.57 Purchased natural resources, intangibles 1 and Crown lands are recognized in government financial statements when they meet the asset definition and the recognition criteria. However, when natural resources, intangibles and Crown lands have been inherited by the government in right of the Crown and have not been purchased, they are not given accounting recognition as assets in government financial statements. Similarly, developed intangibles, as well as all art and historical treasures are also not recognized as assets.

.58 "Human capital" embodies the talent or intellectual capital of government employees; it is not recognized as an asset of government.

.59 Items recognized in government financial statements are accounted for in accordance with the accrual basis of accounting. The accrual basis of accounting recognizes the effect of transactions and events in the period in which the transactions and events occur, regardless of whether there has been a receipt or payment of cash or its equivalent. Accrual accounting recognizes a liability until the obligation or condition(s) underlying the liability is partly or wholly satisfied. Accrual accounting recognizes an asset until the future economic benefit underlying the asset is partly or wholly used or lost.

MEASUREMENT

.60 Measurement is the process of determining the amount at which an item is recognized in the financial statements. There are a number of bases on which an amount can be measured. Government financial statements are, however, prepared primarily using the historical cost basis of measurement, whereby transactions and events are recognized in financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place. Other bases of measurement are also used, but only in limited circumstances.

(a) Replacement cost is the amount that would be needed currently to acquire an equivalent asset. This may be used, for example, when inventories are valued at the lower of historical cost and replacement cost.

(b) Realizable value is the amount that would be received by selling an asset. This may be used, for example, to value portfolio investments. Market value may be used to estimate realizable value when a market for an asset exists.

.61 Present value is the discounted amount of future cash flows expected to be received from an asset or required to settle a liability. Present value is not a basis of measurement, but a valuation technique that may be used within historical cost-based or current-value models. This technique is used in the government reporting model, for example, to estimate the cost of retirement benefits, when determining the estimated total expenditure for closure and post-closure care of a solid waste landfill site, and when determining the "grant portion" of concessionary loans and portfolio investments.

.62 Government financial statements are prepared on the basis that recognized economic resources used up are measured in financial terms with no adjustments made for the effect of a change in the general purchasing power of the currency during the period. Although a government's performance in the management of its service potential 2 is generally a focus more appropriate to the nature and objectives of government, it cannot entirely be measured in financial terms.

.63 Financial statements are prepared on the assumption that the government is a going concern, meaning it will continue in operation, and will be able to realize assets and discharge liabilities and meet its statutory obligations in the normal course of operations for the foreseeable future.

Footnotes

1. Tangible capital assets are defined to include computer software.
1. Recognizing purchased intangibles is addressed in Public Sector Accounting Guideline 8 (PSG-8), *Purchased Intangibles*.
2. Service potential embodies both the quality of service provided and the efficiency with which it is provided.