

Contractual Rights — Basis for Conclusions

Section PS 3380

Foreword

CPA Canada Public Sector Accounting Handbook Revisions Release No. 43, issued in June 2015, contained a new standard, CONTRACTUAL RIGHTS, Section PS 3380.

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

- 1 The Public Sector Accounting Board (PSAB) initiated a project to develop a general application standard on contractual rights, similar to CONTRACTUAL OBLIGATIONS, Section PS 3390, that would:
 - (a) provide a definition of contractual rights and supporting guidance; and
 - (b) establish general disclosure standards for contractual rights.
- 2 An ongoing Conceptual Framework project may result in proposals affecting this standard. PSAB decided not to stop the progress of this project pending completion of Conceptual Framework project.

APPLICATION

- 3 A general application standard is contrasted with a specific application standard for an individual financial statement item. Both form part of generally accepted accounting principles but differ in the breadth of their applicability. A general application standard operationalizes in a broad fashion the existing conceptual framework. A general application standard is useful when a specific application standard does not exist and GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150, requires a chosen accounting treatment to be consistent with the conceptual framework. A general application standard may also be useful when a specific application standard exists; however, it does not directly address the financial statement issue at hand.

DEFINITION

- 4 In determining the definition of contractual rights, consideration was given as to which contractual rights should be within the scope of this standard. PSAB is of the view that the scope should be limited to only those contractual agreements that will result in additional resources available to the entity. After reviewing several definitions aimed at capturing this meaning, Section PS 3380 defines contractual rights as "rights to economic resources arising from contracts or agreements that will result in both an asset and revenue in the future." To ensure that this concept is clear, the standard explicitly states that Section PS 3380 does not include those contractual rights to exchange one asset for another where revenue does not arise.

GUIDANCE

- 5 Most respondents found the guidance on contractual rights useful. Some respondents provided additional suggestions, which included an improvement to the decision tree by adding that contractual rights need to result in both an asset and

revenue. PSAB concluded that ultimately the definition of contractual rights needs to be met. Therefore, if the definition is satisfied then disclosure is necessary. Conversely, no action is needed where the definition is not met. This notion was reflected in the decision tree.

- 6 One respondent was of the view that specifying that the realization of the future asset and revenue does not have to occur at the same time does not add value and complicates the standard. PSAB agreed and removed this aspect.

DISCLOSURE

- 7 The majority of respondents agreed with the proposed disclosure requirements for contractual rights. However, some respondents raised concerns related to the scope of the disclosures. One respondent was confused about whether all material contractual rights need to be disclosed or just those meeting the criteria in the paragraph describing factors to be considered. Another respondent suggested that only those factors should be contemplated in disclosing contractual rights. Yet another respondent was of the view that these factors should be deleted to shift focus to all material contractual rights.
- 8 As provided in the disclosure requirements, information about a public sector entity's contractual rights should be disclosed in the notes or schedules to the financial statements. This requirement includes disclosure of all of those contractual rights meeting the definition, is subject to materiality evaluation and requires the exercise of professional judgment. To help in determining which contractual rights would be disclosed, the standard provides factors that should be considered. However, these factors are only guidelines and not an all-inclusive list.
- 9 In drafting the disclosure requirements, PSAB considered it important to clearly convey that disclosure is necessary as long as a contractual right remains. This was accomplished within the Exposure Draft by stating that: "disclosure of a public sector entity's contractual rights relates to the balance of contracts that remain unperformed." PSAB concluded that this wording may result in confusion as it may give rise to questions of what is meant by unperformed contracts (for example, would it be when one party has performed or when both parties have partially performed). Consequently, PSAB amended the guidance to clarify that once the entity has received an asset, it no longer has a contractual right. This in turn implies that no further disclosures have to be made. Understanding this concept is very important in thinking through disclosure requirements.
- 10 Two respondents expressed concern that disclosure of contractual rights relating to royalty agreements may be challenging due to measurement and sensitivity of information provided in those contracts. One respondent proposed to limit the disclosure to the types of contractual rights to address this issue. PSAB considered contractual rights stemming from royalty contracts and is of the view that the disclosure relating to those contracts could be met by limiting it to information contained in those contracts. For example, the disclosure of "extent" could be limited to providing information about the future revenue from a commodity on a per barrel basis.
- 11 The level of detail disclosed by a public sector entity reflects the highly aggregated nature of financial statements. When deciding the level of detail to disclose, public sector entities consider the usefulness of the information to the reader in assessing the nature and extent of an entity's contractual rights. In some cases, it may be useful to group similar items together. The level of disclosure also considers the sensitivity of the information.
- 12 One respondent suggested that the standard should include a reference to significance in relation to the current financial position or future operations. The PSA Handbook does not define the term "significance" but rather defines and applies the term "materiality". Further, as general guidance on materiality already exists in the PSA Handbook, there is no need to repeat, in individual standards, that only material items should be disclosed.
- 13 One respondent was of the view that the disclosure requirements may create concern around establishing completeness from an operational and audit perspective. PSAB acknowledged that establishing completeness may require some effort. However, PSAB also considered the benefits of the proposed disclosures. They improve the predictive value and, therefore, result in better information for accountability and decision-making purposes. In addition, they complement the disclosure requirements of contractual obligations and thereby contribute to a more balanced view of a public sector entity's future revenue and expenditures.

TRANSITIONAL PROVISIONS

- 14 Section PS 3380 applies to fiscal years beginning on or after April 1, 2017. When an accounting standard is adopted for the first time, the PSA Handbook provides a choice of prospective or retroactive application. ACCOUNTING CHANGES, Section PS 2120, offers further guidance on application. It clarifies that for prospective application the new accounting policy is applied only to events and transactions occurring after the date of the change and to any outstanding related balances existing at the date of the change.
- 15 Given that this is a disclosure standard, both the retroactive and the prospective application would result in the same disclosures. Namely, the following would need to be disclosed:
- all contractual rights where the event (i.e., entering into the contract) occurred after April 1, 2017; and
 - all contractual rights that arose prior to April 1, 2017 and where there are any outstanding related balances existing at the date of the change.
- 16 This would require the public sector entities to review all of its existing contractual rights including those entered into prior to April 1, 2017. PSAB previously considered respondents' concerns with the extent of work required to comply with this standard and supported limiting disclosure of contractual right to only those that give rise to additional

resources. PSAB also agreed that the proposed disclosure improves the predictive value and results in better information for accountability and decision-making purposes.

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