First-time Adoption by Government Organizations — Basis for Conclusions

Section PS 2125

FOREWORD

CICA Public Sector Accounting Handbook Revisions Release No. 31, issued in August 2010, included a new standard, FIRST-TIME ADOPTION BY GOVERNMENT ORGANIZATIONS, Section PS 2125.

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 or removing a standard.

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

August 2010

TABLE OF CONTENTS	Paragraph

BACKGROUND

1 The Introduction to Public Sector Accounting Standards was amended in December 2009 to indicate that the adoption of the CICA Public Sector Accounting (PSA) Handbook by other government organizations should be accounted for by retroactive application with restatement of prior periods for fiscal periods beginning on or after January 1, 2011.

2 Retroactive application with restatement of prior periods means a government organization adopting the PSA Handbook for the first time would be required to prepare financial statements on the transition date as if that organization had always been following the PSA Handbook.

3 Recognizing that, in some cases, applying the PSA Handbook retroactively may be time consuming and costly, in November 2009, the Public Sector Accounting Board (PSAB or the Board) approved an Exposure Draft entitled "First-time Adoption of Public Sector Accounting Standards by Government Organizations," directed at a government organization transitioning from another basis of generally accepted accounting principles (GAAP) to the PSA Handbook.

4 The Exposure Draft proposed a government organization be provided a choice (i.e., an exemption) as to whether it applies some aspects of certain standards retroactively or prospectively. In other cases, the Exposure Draft proposed retroactive application is not appropriate. These are called "exceptions". Exceptions were proposed for certain circumstances where it would be inappropriate for a government organization to update prior decisions or accounting estimates made at the time of the transaction or event.

5 The exemptions and exceptions proposed in the Exposure Draft were directed at the preparation of a government organization's first set of general purpose financial statements in accordance with the PSA Handbook. The purpose of the exemptions and exceptions was to make this transition less onerous.

6 As financial statements of a government organization, other than those classified as a government business enterprise, have been consolidated into its government reporting entity in the past, the transition of a government organization to the PSA Handbook should have no effect on the government reporting entity financial statements.

7 After considering the responses to the Exposure Draft, PSAB approved FIRST-TIME ADOPTION BY GOVERNMENT ORGANIZATIONS, Section PS 2125.

SCOPE

8 In developing the Exposure Draft, PSAB considered that it was important to limit exemptions and exceptions to ensure the financial statements of a government organization were comparable to other financial statements prepared under the PSA Handbook. Areas of the PSA Handbook for which exemptions or exceptions are not specifically provided are to be adopted retroactively.

9 PSAB also considered that a government organization may elect not to use the exemptions offered, as the information required to adopt the PSA Handbook retroactively is available and has been reported by a government organization to its government reporting entity for consolidation purposes in the past. A government organization is not prevented from adopting the entire PSA Handbook on a retroactive basis.

10 Respondents to the Exposure Draft raised additional aspects of the PSA Handbook in which exemptions should be offered. After consideration, PSAB decided to limit the exemptions to those proposed in the Exposure Draft. The Board concluded exemptions were not appropriate in the following areas for the reasons indicated below:

(a) Financial instruments — Due to the uncertainty of the content and timing of a new PSA Handbook financial instrument standard being developed, the Board concluded that a government organization should adopt the existing requirements in the PSA Handbook for those types of financial instruments that are addressed (for example, regarding temporary and portfolio investments).

(b) Related party transactions — Unlike in the CICA Handbook – Accounting, there is no general related party transaction standard in the PSA Handbook, although there are requirements on specific matters throughout the PSA Handbook. The Board concluded that adoption of the PSA Handbook should not result in a revaluation of prior related party transactions unless those transactions are inconsistent with the specific requirements in the PSA Handbook. Where prior transactions are inconsistent with specific requirements of the PSA Handbook, those transactions would need to be remeasured.

(c) Revaluation of tangible capital assets (TCAs) — The unamortized cost of TCAs represents service potential rather than future cash flows as under the profit-oriented standards. A revaluation of a TCA would not necessarily reflect a change in service potential. The Board did not consider it appropriate to allow the revaluation of TCAs, which would impact the financial position and results of a government organization.

(d) Leased TCAs — While conceptually the PSA Handbook and CICA Handbook – Accounting standards are the same for lease contracts, the factors to be considered under the two Handbooks as to whether the benefits and risks of ownership have been transferred do vary. The Board concluded that it was important to have the appropriate TCAs recorded on the financial statements on transition to the PSA Handbook and that no exemption should be offered.

11 PSAB also reviewed the guidance provided in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section PS 1150, with respect to reference to an alternative basis of GAAP, and confirmed its appropriateness for a government organization transitioning to the PSA Handbook for topics that are not covered in the PSA Handbook (for example, accounting for equity, asset retirement obligations and inventories).

EXEMPTIONS

Discount rate used in actuarial valuation

12 Respondents were generally supportive of offering an exemption that would allow a government organization the option to delay applying the discount rate required under RETIREMENT BENEFITS, Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255, until the next regularly scheduled actuarial valuation.

13 Some respondents suggested that such a delay in changing the discount rate was unnecessary as a government organization should be able to recalculate its plan obligations on transition through extrapolation and that delaying the change in discount rate would result in inconsistent accounting for any resulting actuarial gains or losses. Some

respondents also indicated that it should be clarified as to whether the exemption could be applied on a plan-by-plan basis.

14 PSAB considered the matters raised by respondents and, while recognizing that some government organizations would be able to update their actuarial obligations, decided it was important to allow a delay with respect to the discount rate for those government organizations where such information may not be available so as to not have to incur an additional actuarial valuation.

15 If an actuarial valuation is delayed until after the transition date, any resulting actuarial gain or losses are to be accounted for on a going forward basis in accordance with RETIREMENT BENEFITS, paragraph PS 3250.062, and amortized in a systematic and rational manner over the expected average remaining service life of the related employee group. PSAB recognized that delaying the change in discount rate until after the transition date may result in different accounting for the resulting actuarial gains and losses, compared to when the actuarial gains or losses are calculated on transition to the PSA Handbook. The Board concluded that the delay in applying the discount rate was an option that should be available for a government organization due to the time and cost involved. Alternatively, a government organization would be able to revalue its obligations on transition using the discount rate required under Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255.

16 To prevent delaying the change in the discount rate on a selective basis, paragraph PS 2125.09 states that if a government organization uses this exemption, it should do so for all plans.

Recognition of actuarial gains and losses

17 Respondents were generally supportive of offering an exemption that would allow a government organization the option to recognize all cumulative unrecognized actuarial gains and losses under RETIREMENT BENEFITS, Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255, on the date of transition to the PSA Handbook.

18 Similar to the prior exemption, some respondents suggested offering such an exemption would result in inconsistent accounting for actuarial gains or losses and it should be clarified as to whether the exemption could be applied on a plan-by-plan basis.

19 PSAB recognized that allowing all actuarial gains and losses to be recognized would be inconsistent with the accounting for similar actuarial gains and losses after transition to the PSA Handbook but concluded, due to the time and cost involved, that such an exemption should be available for a government organization. Alternatively, a government organization would be able to calculate its unamortized gains and losses on transition in accordance with RETIREMENT BENEFITS, Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255.

20 To prevent the recognition of actuarial gains and losses on a selective basis, paragraph PS 2125.10 states that if a government organization uses the exemption, it should do so for all plans.

Business combinations

21 Respondents were generally supportive of offering an exemption that would allow ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, for acquisitions to be adopted prospectively.

22 Some respondents did raise a concern that a government organization may selectively restate only certain acquisitions on a retroactive basis, while some respondents requested further clarification as to the treatment on transition of previously recognized assets and liabilities that were not in accordance with the PSA Handbook.

23 To prevent restatement of only selective acquisitions on a retroactive basis, paragraph PS 2125.11 states that if a government organization restates any acquisition to comply with ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, it restates all acquisitions from that same date.

24 PSAB also confirmed that if a government organization chooses to adopt ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, prospectively with respect to business combinations, any item recognized previously (including purchase premiums) that does not qualify for recognition as an asset or liability under the PSA Handbook would not be recorded on transition. The resulting adjustment to remove the previously recorded asset or liability would be to accumulated surplus / deficit on transition.

Investments in government business enterprises

25 Respondents were generally supportive of offering an exemption that would allow INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, to be adopted prospectively.

26 Some respondents did raise a concern that a government organization may selectively restate only certain investments in government business enterprises on a retroactive basis, while some respondents requested further clarification regarding the determination of the investment in government business enterprises balance on transition to the PSA Handbook if a government organization elected to account for these investments prospectively.

27 To prevent restatement of only selective investments in government business enterprises on a retroactive basis, paragraph PS 2125.12 states that if a government organization restates any investment in a government business enterprise to

comply with INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, it restates all investments in government business enterprises from that same date.

28 PSAB also confirmed that if a government organization chooses to adopt INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, prospectively, the investment in a government business enterprise balance reflected in the opening statement of financial position of the government organization on transition to the PSA Handbook would be based on the asset and liability balances reflected in the government business enterprise's financial statement on the date of transition. For example, the date of transition for a government organization with a December 31 year end is January 1, 2010. The government business enterprise's financial statement on December 31, 2009 or January 1, 2010, prepared under International Financial Reporting Standards (IFRSs) or the CICA Handbook – Accounting, would be used to calculate the opening investment on the government business enterprise balance on the transition date in accordance with Section PS 3070.

Government business partnerships

29 Respondents were generally supportive of offering an exemption that would allow GOVERNMENT PARTNERSHIPS, Section PS 3060, to be adopted prospectively.

30 Some respondents did raise a concern that a government organization may selectively restate only certain government business partnerships on a retroactive basis, while some respondents requested further clarification regarding the determination of the government business partnership balance on transition to the PSA Handbook if a government organization elected to account for these investments prospectively.

31 To prevent restatement of only selective government business partnerships on a retroactive basis, paragraph PS 2125.13 states that if a government organization restates any government business partnership to comply with GOVERNMENT PARTNERSHIPS, Section PS 3060, it restates all government business partnerships from that same date.

32 PSAB also confirmed that if a government organization chooses to adopt GOVERNMENT PARTNERSHIPS, Section PS 3060, prospectively, the government business partnership balance reflected in the opening statement of financial position of the government organization would be based on the asset and liability balances reflected in the government business partnership's financial statements on the date of transition. For example, the date of transition for a government organization with a December 31 year end is January 1, 2010. The government business partnership's financial statement on December 31, 2009 or January 1, 2010, prepared under IFRSs or the CICA Handbook – Accounting, would be used to calculate the opening government business partnership balance on the transition date in accordance with Section PS 3060.

Tangible capital asset impairment

33 Some respondents expressed concern that it was being proposed in the Exposure Draft that a government organization not be provided the option of being able to review prior write-downs in accordance with TANGIBLE CAPITAL ASSETS, Section PS 3150. Respondents considered the different basis for recording write-downs of TCAs between the CICA Handbook – Accounting and the PSA Handbook to be a fundamental difference that a government organization should be able to adjust when it adopts the PSA Handbook. These respondents indicated the information to restate prior write-downs of TCAs to be on a PSA Handbook basis was available and has been reported to the government reporting entities in the past. By not permitting retroactive adoption of Section PS 3150, write-downs of TCAs prior to transition would be accounted for differently in the standalone financial statements of a government organization relative to the financial statements of its government reporting entity.

34 PSAB considered the concerns raised by respondents and agreed government organizations adopting the PSA Handbook should be given the option of reassessing whether prior write-downs of TCAs were necessary and, if so, their amounts based on the requirements of the PSA Handbook. Therefore, an exemption has been provided in paragraph PS 2125.14.

EXCEPTIONS TO RETROACTIVE APPLICATION

Hedge accounting

35 Respondents were supportive of including an exception on hedge accounting that would prevent transactions entered into before the date of transition to be retroactively designated as hedges. No significant areas of concern regarding the hedge accounting exception were raised by respondents.

Accounting estimates

36 Respondents were supportive of including the exceptions regarding estimates, recognizing it is important that estimates used in preparing the financial statements on transition to the PSA Handbook are consistent with those used at the time the statements under the CICA Handbook – Accounting were prepared and without the benefit of hindsight. No significant areas of concern regarding the estimate exceptions were raised by respondents.

CONSOLIDATION

37 An additional matter raised by respondents to the Exposure Draft was the effect the exemptions and exceptions would have on the financial statements of a government organization's government reporting entity.

38 Other than a government business enterprise, a government organization is consolidated in the financial statements of its government reporting entity. Prior to its transition to the PSA Handbook, adjustments would have been made, on consolidation, to conform the accounting policies of organizations using the CICA Handbook – Accounting to those of

their government reporting entity under the PSA Handbook in accordance with BASIC PRINCIPLES OF CONSOLIDATION, paragraph PS 2500.02.

39 On adoption of the PSA Handbook, a government organization may elect certain exemptions under Section PS 2125. The election of an exemption represents an accounting policy of a government organization, not of its government reporting entity. While the financial statements of the government organization will be in accordance with the PSA Handbook, differences in accounting policies between the organization and its government reporting entity will still need to be adjusted on consolidation.

40 As an example, consider a government organization that accounted for TCAs in the past under the CICA Handbook – Accounting (taking write-downs as economic recoverability had been impaired) resulting in a net book value of its TCAs of $5 million at transition date. The net book value of the TCAs, had the organization adhered to the PSA Handbook, would have been $8 million as service potential was not impaired.

41 Prior to transition, the TCAs in the government reporting entity would have been adjusted to $8 million as the government reporting entity financial statements are prepared in accordance with the PSA Handbook.

42 In the government organization's financial statements, the organization could elect to account for write-downs of TCAs under the PSA Handbook on a prospective basis, and continue to have a net book value of TCAs, on transition, of $5 million, or the organization could adopt TANGIBLE CAPITAL ASSETS, Section PS 3150, retroactively, which would result in a net book value of TCAs on transition of $8 million.

43 In the government reporting entity financial statements, the net book value of TCAs of its government organization, on consolidation, would continue to be $8 million. The election of this exemption by the government organization and other exemptions offered in Section PS 2125 should not impact the financial statements of the government reporting entity.
