

Contingent Assets — Basis for Conclusions

Section PS 3320

Foreword

CPA Canada Public Sector Accounting Handbook Revisions Release No. 43, issued in June 2015, contained a new standard, CONTINGENT ASSETS, Section PS 3320.

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 contingent assets, similar to CONTINGENT LIABILITIES, Section PS 3300, that would:
 - (a) provide a definition of contingent assets and supporting guidance; and
 - (b) establish general disclosure standards for contingent assets.
- 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 the 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.

GUIDANCE

- 4 Section PS 3320 was developed in order to enhance users' understanding of which items meet the definition. Most respondents found the guidance useful. One respondent was of the view that a link between contingent assets and assets is missing. Another respondent asked for more guidance to clarify when a contingent asset becomes an asset. This matter was considered during the course of the project. In the case of contingent assets, there is uncertainty as to the existence of the asset. As a result, there is doubt whether control of the economic resource exists at the financial statement date. It is only the future event that will confirm that the entity had an asset and, therefore, it is only the future event that will confirm control of the economic resource at the financial statement date. This distinction between a contingent asset and an asset was described in the Exposure Draft and is included in paragraph PS 3320.04. In addition, users of Section PS 3320 are encouraged to read Section PS 3320 in conjunction with ASSETS, Section PS 3210.
- 5 To illustrate the concept of the existence of uncertainty, an example of a public sector entity that incurred an unexpected loss where there is sufficient evidence for potential recovery is provided. This could be the case where an entity expects

to win a lawsuit and recover a loss. PSAB is of the view that this situation illustrates the existence of uncertainty rather than measurement uncertainty as there is only potential for recovery and hence the recovery is uncertain. On the other hand, tax receivable is an example of measurement uncertainty. This is because there is nothing uncertain about whether the asset exists. The past transaction giving rise to the asset has already occurred.

- 6 The Exposure Draft indicated that assessing the likelihood of the future confirming event occurring, including estimating its financial effects, is a matter for judgment by those responsible for preparing the financial statements. One respondent thought that this statement may be misinterpreted to mean that the ability to estimate the financial effects accurately should be considered when determining the likelihood of the future confirming event. The purpose of this guidance is to convey that assessing the existence and measurement are matters of professional judgment. PSAB amended this guidance to convey the intended meaning.

DISCLOSURE VERSUS RECOGNITION

- 7 Over the course of the project, PSAB considered whether contingent assets should be recognized or disclosed. PSAB concluded that recognition of contingent assets could result in recognition of items as assets that do not meet the assets definition and, therefore, be contrary to the existing conceptual framework. PSAB is of the view that disclosure of contingent assets provides relevant and reliable information for accountability and decision-making purposes while addressing the risks associated with the recognition of contingent assets.
- 8 Respondents were also asked to consider whether they agree with limiting the recognition of contingent assets to cases where a contingent asset may be recognized as part of a reduction to a related contingent liability (see CONTINGENT LIABILITIES, paragraph PS 3300.25). Most respondents supported this treatment. PSAB agreed that for the purposes of contingent liabilities, likely recoveries are part of the measurement of contingent liabilities.

DISCLOSURE

- 9 Most respondents were supportive of the disclosure requirements for contingent assets. One respondent was of the view that the concept of materiality should be included in the standard and there should be a reference to significance in relation to the current financial position or future operations. 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.
- 10 One respondent noted an inconsistency between the guidance on contingent assets and CONTINGENT LIABILITIES, Section PS 3300, in that Section PS 3300 requires disclosure of non-determinable contingent liabilities whereas the same is not required for contingent assets. PSAB is aware of this inconsistency and decided not to disclose non-determinable contingent assets because of the principle of conservatism.
- 11 The guidance on disclosure of contingent assets states that the level of disclosure considers the sensitivity of the information. One respondent indicated that this guidance may be overused. As a preventative measure, the respondent suggested mentioning that sensitive situations are rather rare. PSAB believes that alerting preparers in this way may not add value and that professional judgment needs to be used to determine if a situation warrants the use of this particular guidance.