

Invitation to Comment

Financial Reporting by Government Organizations

prepared by:
Public Sector Accounting Board

Comments are requested by April 17, 2009

PSAB

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Responding to this Invitation to Comment

This Invitation to Comment (ITC) is issued by the Public Sector Accounting Board (the Board). The members of the Board are drawn from government, public accounting practice, business and academe. All members serve as individuals, not as representatives of their governments, employers or organizations.

Individuals, governments and organizations are invited to send written comments to the Board on the ITC. Comments are most helpful if they clearly identify the preferred alternative supported by their reasoning.

All comments received will be available on the website at www.psab-ccsp.ca ten days after the comment deadline, unless confidentiality is requested.

To be considered, comments must be received by April 17, 2009, addressed to:

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For ease of handling, we prefer comments to be sent by e-mail (in Word format) to:
ed.psector@cica.ca.

Financial Reporting by Government Organizations

A number of government organizations will be required to change their source of generally accepted accounting principles (GAAP) effective for fiscal periods beginning on or after January 1, 2011. Organizations may be required to change from the CICA Handbook – Accounting to International Financial Reporting Standards (IFRSs) as a result of their adoption. This represents a unique opportunity for all government organizations to conduct a detailed review of their current classifications and consider their sources of GAAP. Based on the results of this Invitation to Comment (ITC), some government organizations may be reclassified and directed to a different source of GAAP. Some government organizations may review their current classification and determine their current government organization type is not appropriate which may also result in a change in the source of GAAP. Finally, some government organizations that are able to self-select between IFRSs or the Public Sector Accounting Handbook may choose to change the source of GAAP they have selected. Therefore, the matters discussed in this ITC may have a consequence on the source of accounting for many government organizations in Canada.

Information about the difference between IFRSs and the CICA Handbook – Accounting can be found on the AcSB website at www.acsbcanada.org.

PURPOSE AND SCOPE

1. The purpose of this Invitation to Comment (ITC) of the Public Sector Accounting Board (PSAB) is to seek views on the breadth of application of International Financial Reporting Standards (IFRSs) to Canadian government business enterprises (GBEs) and government business-type organizations (GBTOs). The CICA Handbook – Accounting, as it applies to profit-oriented enterprises, will no longer exist in its current form for fiscal periods beginning on or after January 1, 2011 (the “changeover” date). Therefore, these government organization types, which are currently following that Handbook, will need to change the source of GAAP they are following as at that date.
2. This ITC also seeks views on the appropriate method of accounting for a change in the source of generally accepted accounting principles (GAAP) used by government organizations.
3. This ITC proposes to continue to allow other government organizations (OGOs) to select the most appropriate source of GAAP, either IFRSs or the Public Sector Accounting (PSA) Handbook. OGOs are those government organizations that are not GBEs, GBTOs or government not-for-profit organizations (GNFPOs). GAAP for GNFPOs is being considered in a separate ITC issued jointly by PSAB and the

Accounting Standards Board (AcSB) and therefore is not addressed in this paper. Any government organizations that may have been reclassified as GNFPOs are encouraged to respond to that ITC. A copy of that [ITC](#) is available.

4. This ITC does not revisit the definition of GBEs nor does it revisit the accounting requirements contained in GOVERNMENT REPORTING ENTITY, Section PS 1300 of the PSA Handbook. Government organizations will continue to be consolidated in a government's financial statements with the exception of GBEs as currently defined. GBEs will continue to be accounted for using modified equity accounting. The application of IFRSs to these government organizations does not effect how these organizations are accounted for in the government reporting entity.
5. This ITC is based on existing definitions of all government organization types recognizing that, in current practice, there may be inconsistent application of these definitions. Their application should be reviewed on a regular basis by the government organizations. For example, a GBTO could meet the test of a GBE or GNFPO, or alternatively, a GBE may no longer be self-sustaining. If an organization is currently misclassified, existing guidance would require it to be reclassified. It is important for each government organization to ensure that it is correctly classified before making assessments about the proposed alternatives in this ITC and their effect. The section following provides definitions and related guidance for your reference.
6. This ITC does not address the issue of rate-regulated accounting. This topic is currently under consideration by the International Accounting Standards Board.
7. After considering responses to this ITC, PSAB will determine whether amendments to the existing Introduction to Public Sector Accounting Standards (the Introduction) are required.

DEFINITIONS

8. The following definitions have been provided for your reference for purposes of reviewing and responding to this ITC.

AcSB

The AcSB is currently reviewing the definition of a **publicly accountable enterprise**. A definition will be proposed in the "Adopting IFRSs in Canada, II" exposure draft scheduled for release by the AcSB in March 2009. The fundamental concept is that a publicly accountable enterprise is an entity that has issued (or is in the process of issuing) debt or equity instruments in a public market or which holds assets in a fiduciary capacity for a broad group of outsiders.

PSAB

A **government business enterprise** is a government organization that has all of the following characteristics:

- (a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;
- (b) it has been delegated the financial and operational authority to carry on a business;
- (c) it sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and
- (d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

Examples of GBEs include Canada Post Corporation and Toronto Hydro Corporation

A **government business-type organization** is a government organization that has all of the following characteristics:

- (a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;
- (b) it has been delegated the financial and operational authority to carry on a business; and
- (c) it sells goods and services to individuals and organizations as its principal activity.

Examples of GBTOs include Via Rail Canada Inc. and Toronto Transit Commission

Selling goods and services involves a direct exchange relationship between the revenues and the goods and services provided. Selling prices are related to the quantity and quality of goods or services sold, and not just to the recovery of administrative costs. Imposed fees and penalties, such as licenses and fines, do not represent sales of goods and services. Insurance premiums charged by a government organization are a sale of a service and not an imposed fee.

A **government not-for-profit organization** is a government organization that meets the definition of a not-for-profit organization in the CICA Handbook – Accounting¹ and that has counterparts outside the public sector as defined in paragraph .03 of the Introduction.

¹ FINANCIAL STATEMENT PRESENTATION BY NOT-FOR-PROFIT ORGANIZATIONS, CICA HANDBOOK – ACCOUNTING paragraph 4400.02, defines not-for-profit organizations as entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

International Public Sector Accounting Standards Board (IPSASB)

A **government business enterprise** means an entity that has all of the following characteristics:

- (a) is an entity with the power to contract in its own name;
- (b) has been assigned the financial and operational authority to carry on a business;
- (c) sells goods and service, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) is controlled by a public sector entity.

IPSASB's Preface to International Public Sector Accounting Standards also indicates that International Public Sector Accounting Standards apply to all public sector entities except GBEs.

BACKGROUND

- 9. Prior to 1981 and the establishment of PSAB, the only source of GAAP was the CICA Handbook – Accounting. Many Crown corporations and some municipal corporations followed the CICA Handbook – Accounting, as legislation or regulations required these organizations to report on a GAAP basis.
- 10. In 1988, because certain corporations were operating like a business and were self-sustaining, PSAB established the definition of GBEs to identify which organizations would be accounted for by modified equity. All other government organizations other than GBEs are accounted for by consolidation.
- 11. In 1996, the AcSB defined not-for-profit organizations, and this raised questions as to whether all non-GBEs should follow not-for-profit GAAP. In response, PSAB revised its Introduction by defining GBTOs and directing them to use the same basis of GAAP as GBEs, and by defining GNFPs and directing them to not-for-profit GAAP. All other government organizations were allowed to select the source of GAAP (either the CICA Handbook – Accounting or the PSA Handbook) that is most appropriate based on their objectives and circumstances.
- 12. Pursuant to the AcSB's Strategic Plan, publicly accountable enterprises would be directed to IFRSs and private enterprises would be directed to a yet to be developed GAAP. This raised a public sector issue regarding which source of GAAP GBEs and GBTOs should adopt – IFRSs, PSA standards or private enterprise GAAP. In 2006, PSAB undertook to address this issue.
- 13. Based on the comments received on an Exposure Draft issued in 2007, PSAB directed GBEs and GBTOs to follow IFRSs, as it was designed to address profit-oriented enterprises, there was international support for IFRSs, private enterprises GAAP was yet to be developed, the PSA Handbook was not designed for these

types of organizations and not-for-profit GAAP was not suitable. PSAB issued the revised Introduction in February 2008.

RATIONALE FOR CURRENT POSITION

14. In revising the Introduction, PSAB considered the following:

- (a) Many GBEs and GBTOs would not meet the definition of “publicly accountable enterprises” as defined by the AcSB.

While many GBEs and GBTOs may not have widely held debt and equity interests, a large number of stakeholders in the public sector do not have a right to additional information and depend primarily on the financial statements for information.

Deciding whether IFRSs should be applied to GBEs and GBTOs based on their financing would introduce incomparability among GBEs and GBTOs. This lack of comparability was an important consideration for PSAB.

- (b) GBEs and GBTOs would need to incur costs in order to change their source of GAAP.

Change was inevitable because the CICA Handbook – Accounting was changing and could not be “frozen” in its current state whether it be changing to IFRSs or the PSA Handbook.

PSAB also considered whether an exception should be made for smaller organizations but maintained its position that public sector organizations have a responsibility to be publicly accountable regardless of the size of the organization.

- (c) GBTOs, because they are consolidated in government reporting entities’ financial statements, would need to address GAAP differences if they were not directed to the PSA Handbook.

This issue was not a new requirement, as GBTOs were preparing their financial statements based on the CICA Handbook – Accounting and differences exist with the PSA Handbook requiring consolidation adjustments. RETIREMENT BENEFITS, Section PS 3250, is a good example of a difference requiring consolidation adjustments. PSAB was not persuaded that the selection of the source of GAAP for GBTOs should be based on ease of consolidation.

15. After performing its due diligence and after considering the responses to the 2007 Exposure Draft, PSAB confirmed in the Introduction that GBEs and GBTOs would continue to follow GAAP for publicly accountable enterprises. Similarly, it was confirmed that OGOs would be able to continue to self-select between the PSA Handbook and CICA Handbook – Accounting.

ALTERNATIVES IDENTIFIED BUT CONSIDERED INAPPROPRIATE

16. A number of stakeholders continue to raise concerns as to the breadth of application of IFRSs in the public sector. To address these concerns, PSAB considered a number of alternatives when developing this ITC that it does not believe are appropriate for government organizations:
 - (a) *Private enterprise standards* — Private enterprise standards are currently being developed by the AcSB for organizations that have no, or a limited number of, external stakeholders that rely on general purpose financial statements. The private enterprise GAAP being developed, while based on the AcSB's conceptual framework, proposes simplified accounting treatments and includes reduced disclosure requirements. As government organizations are accountable to the public, this source of GAAP is not considered appropriate for government organizations.
 - (b) *Total self-selection* — PSAB could remove any direction to all government organizations as to which source of GAAP they should use. While the PSA Handbook is now a full accrual accounting based financial reporting model, it is specifically designed to address the unique needs of government as opposed to business-like enterprises. In addition, total self-selection could lead to the introduction of non-comparability. Further, this would place the onus on the preparer and auditor to agree on the most appropriate source of GAAP to be applied in any given circumstance without the benefit of a framework to apply. PSAB is of the general view that business enterprises in the public sector should continue to follow the same source of GAAP as those in the private sector. Therefore, self-selection for all government organizations is not considered appropriate.
 - (c) *Size test* — A size test could be applied to certain GBEs and GBTOs exempting them from IFRS. This introduces a comparability issue relating two similar government organizations following two different bases of accounting and financial reporting. The use of a size test is considered to be arbitrary, easily abused by managing thresholds and not a good indicator of financial reporting needs. The size test was considered inappropriate by the AcSB and is also not included in any of the alternatives proposed.

OTHER ALTERNATIVES FOR CONSIDERATION

17. Other than the status quo, there are four alternatives set out for your consideration. These alternatives result in applying IFRSs to:
- (1) those government organizations that are a “publicly accountable enterprise” as proposed by the AcSB;
 - (2) GBEs as defined by PSAB;
 - (3) the same types of organizations as defined by the IPSASB; or
 - (4) all GBEs and only those GBTOs as defined by PSAB that are competing with similar entities outside of the public sector that also follow IFRSs.
18. The following is an illustration comparing the source of GAAP for each government organization type under each of the proposed alternatives in addition to the current requirements of the PSA Handbook. In the illustration below, self-selection allows GBEs, GBTOs and OGOs to follow the PSA Handbook or elect to apply IFRSs based on their objectives and circumstances.

	Current requirement	Alternative 1	Alternative 2	Alternative 3	Alternative 4
GBEs	IFRSs	Publicly accountable — IFRSs	IFRSs	IFRSs	IFRSs
		Remainder — Self-selection*			
GBTOs	IFRSs	Publicly accountable — IFRSs	Self-selection*	Self-sustaining — IFRSs	Private sector competitor — IFRSs
		Remainder — Self-selection*		Remainder — Self-selection*	Remainder — Self-selection*
GNFPOs	Under review in a separate AcSB/PSAB ITC				
OGOs	Self-selection*				

* PSA Handbook or can elect to apply IFRSs

Alternative 1 — Applying IFRSs to those government organizations that are a “publicly accountable enterprise” as proposed by the AcSB

19. This approach would:
 - (a) Limit the application of IFRSs to those profit-oriented GBEs and GBTOs:
 - (i) that have issued, or are in the process of issuing, debt or equity instruments that are or will be outstanding and traded in a public market; or
 - (ii) whose primary business is to hold assets in a fiduciary capacity for a broad group of outsiders such as banks, credit unions, and insurance companies including auto, crop, health and workers’ safety.
 - (b) Allow GBEs and GBTOs that do not meet the AcSB’s definition of a “publicly accountable enterprise” to be able to select the most appropriate source of GAAP based on their objectives and circumstances. The remaining GAAP choices, given that private enterprise GAAP was not considered an appropriate alternative, would be IFRSs or the PSA Handbook.
20. Government organizations provide goods and services to the public who are often the major financial resource providers. Primary users of financial reporting by government organizations include those government reporting entities that control them and the public they serve. User needs are focused primarily on the delivery of services, fiscal accountability and stewardship of resources in addition to any financing decisions. Public accountability for government organizations is broader than it is in the private sector.
21. Use of the AcSB definition of a “publicly accountable enterprise” will introduce incomparability between similar public sector entities based on the method of financing. For example, a government organization financed by external debt could be accounted for differently than a similar government organization financed through general government borrowings.
22. As most government organizations are not financed externally by debt or equity instruments that are traded publicly, most government organizations currently classified as either a GBE or GBTO would be able to self-select their basis of GAAP between the PSA Handbook and IFRSs. The number of government organizations that would be required to adhere to IFRSs as of the “changeover” date would be limited.
23. In summary, some of the advantages of this alternative are as follows:
 - (a) It will result in public sector entities and private sector entities being directed to IFRSs based on the AcSB’s definition of a “publicly accountable enterprise”;
 - (b) It permits all other GBEs and GBTOs to be accounted for on the same basis as the government reporting entity (using the PSA Handbook if selected), thereby reducing consolidation adjustments; and
 - (c) It does not eliminate any options currently available to government organizations but provides more choice to certain entities thereby allowing greater flexibility.

Alternative 2 — Applying IFRSs to GBEs as defined by PSAB

24. This approach would:
 - (a) Apply IFRSs to those government organizations that meet PSAB’s existing definition of GBEs;
 - (b) Eliminate the need for a definition of GBTOs. These government organizations would be considered OGOs and thus reduce uncertainty in the application of the GBTOs definition; and
 - (c) Potentially reduce consolidation adjustments relating to GBTOs if the PSA Handbook were selected by these entities.
25. There does not appear to be an issue with understanding and applying the definition of a GBE. This approach would require that all GBEs apply IFRSs, thereby improving comparability among similar organizations regardless of the method of financing.
26. GBTOs would be reclassified as OGOs. These government organizations would be able to self-select either IFRSs or the PSA Handbook based on their objectives and circumstances.
27. In summary, some of the advantages of this alternative are as follows:
 - (a) It provides consistency by directing all GBEs to IFRSs;
 - (b) It permits all non-GBEs to be accounted for on the same basis as the government reporting entity (using the PSA Handbook if selected);
 - (c) It does not eliminate any options available to government organizations but provides more choice to certain entities thereby allowing greater flexibility; and
 - (d) It reduces definitional complexity in the the PSA Handbook by eliminating the GBTOs' definition and grouping, and retaining the existing GBEs definition.

Alternative 3 — Applying IFRSs to the same types of organizations as defined by the International Public Sector Accounting Board (IPSASB)

28. This approach would apply IFRSs to:
 - (a) all government organizations that meet PSAB’s existing definition of GBEs; and
 - (b) self-sustaining GBTOs (i.e., those that are not reliant on continuing government funding to be a going concern other than purchases of outputs at arm’s length).
29. PSAB’s existing definition of GBEs falls within the scope of the IPSASB’s definition of GBEs. In addition, some GBTOs, as classified under the PSA Handbook, may meet the IPSASB’s requirements of GBEs even though they are selling goods and services inside the reporting entity. PSAB is not proposing to change the definitions of GBEs and GBTOs, nor is it proposing to change the use of modified equity accounting for GBEs or full consolidation of GBTOs as is currently the requirement.

30. Those GBTOs that do not meet the IPSASB's definition would be permitted to self-select the most appropriate source of GAAP (either the PSA Handbook or IFRSs) based on their objectives and circumstances.
31. In summary, some of the advantages of this alternative are as follows:
 - (a) It provides consistency by directing all self-sustaining entities to IFRSs;
 - (b) It permits all other government organizations to be accounted for on the same basis as the government reporting entity (using the PSA Handbook if selected);
 - (c) It does not eliminate any options available to government organizations but provides more choice to certain entities, thereby allowing greater flexibility;
 - (d) It reduces application difficulties by limiting the GBTOs definition to those that are self-sustaining; and
 - (e) It improves consistency with international standards.

Alternative 4 — Applying IFRSs to all GBEs and only those GBTOs as defined by PSAB that are competing with similar entities outside of the public sector that also follow IFRSs

32. This approach would:
 - (a) Limit the application of IFRSs to all GBEs and only those GBTOs that are competing with similar entities outside of the public sector that follow IFRSs; and
 - (b) Require the notion of similar competing entities outside of the public sector to be included in the existing definition of GBTOs for the purposes of applying IFRSs.
33. Currently, paragraph 12 of the Introduction indicates a GNFPO is “a government organization that meets the definition of a not-for-profit organization in the CICA Handbook – Accounting and that has counterparts outside the public sector.” A GNFPO is currently directed to adhere to the standards for not-for-profit organizations in the CICA Handbook – Accounting. Only government organizations that both meet the definition of a not-for-profit organization and have counterparts in the non-government sector are required to adhere to the CICA Handbook – Accounting.
34. Under this alternative, organizations currently classified as GBTOs would apply IFRSs when they are competing with similar entities which follow IFRSs in the private sector. There is a more direct need for comparability for government organizations that have a competitor that follows IFRSs. All other GBTOs would be able to self-select either IFRSs or the the PSA Handbook based on their objectives and circumstances.
35. In summary, some of the advantages of this alternative are as follows:
 - (a) It will result in IFRSs for all GBEs and only those GBTOs that are competing with similar entities in the private sector that also apply IFRSs promoting consistency with comparable private sector enterprises;

- (b) It permits other GBTOs to be accounted for on the same basis as the government reporting entity (using the PSA Handbook if selected); and
- (c) Permits options by providing more choice to certain entities, thereby allowing greater flexibility.

TRANSITIONAL MATTERS FOR CONSIDERATION

- 36. For those government organizations whose source of GAAP is changing, the relevant guidance regarding a change in accounting standards in IFRSs and the PSA Handbook are provided below.
- 37. Certain government organizations may be required or choose to adopt IFRSs. *First-Time Adoption of International Financial Reporting Standards*, IFRS 1, paragraph 7 notes:
 - An entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements.
- 38. In other cases, certain government organizations may change from using CICA Handbook – Accounting to the PSA Handbook. ACCOUNTING CHANGES, paragraph PS 2120.06, lists the following three alternatives to deal with a change in accounting policy:
 - (a) prospective application;
 - (b) retroactive application with no restatement of prior periods; and
 - (c) retroactive application with restatement of prior periods.
- 39. It is proposed for government organizations that are required or choose to adopt the PSA Handbook, that this change in standards be applied using retroactive application with restatement of prior periods. This approach is similar to the requirements with the first-time adoption of IFRSs.

COMMENTS REQUESTED

PSAB welcomes comments on the proposed alternatives presented in this ITC.

In particular, respondents are requested to answer the following questions:

- 1. Do you agree with the status quo? Please explain your reasons why or why not.
- 2. If you do not agree with the status quo, which of the stated alternatives is your preferred alternative, and why?
- 3. Of the other stated alternatives, please indicate which, if any, that you would prefer over the status quo, and why?
- 4. Are there any other alternatives, not suggested that you prefer and why?

5. Do you agree that OGOs should be able to self-select between the PSA Handbook and IFRSs and why? If you do not agree, what basis of accounting for OGOs should be used, and why?
6. Do you agree that when government organizations adopt the PSA Handbook, the change in accounting policy should be treated as a retroactive adjustment with restatement of prior periods? If not, why not?
7. Are there any additional matters that you feel may be relevant to this topic that need to be considered?