

Issues Analysis: First-time Adoption of Public Sector Accounting Standards by Government Organizations

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Introduction

- .01 This issues analysis is a supporting document to the Public Sector Accounting Board (PSAB) Exposure Draft (ED), “First-time Adoption of Public Sector Accounting Standards by Government Organizations.” It provides information regarding the process followed in preparing the ED and how significant matters identified have been dealt with. The analysis has not been issued under the authority of PSAB. Prior to approving a final standard, the Board will review and deliberate responses submitted to the ED.

Purpose and scope

- .02 The ED is directed at government organizations that are adopting the CICA Public Sector Accounting (PSA) Handbook for the first-time and transitioning from the CICA Handbook – Accounting, ACCOUNTING CHANGES, Section PS 2120, addresses the requirements for transitioning from a non-GAAP basis of accounting (for example, on a cash basis) to the PSA Handbook.
- .03 As a result of the December 2009 amendment to the Introduction to Public Sector Accounting Standards, the government business-type organization classification was eliminated. These government organizations will be recategorized as either other government organizations (OGOs) or government not-for-profit organizations.
- .04 Government organizations adopting the PSA Handbook are to account for the transition by retroactive application with restatement of prior periods except when otherwise allowed or required. Retroactive application with restatement of prior periods requires a government organization adopting the PSA Handbook to prepare financial statements on the transition date as if that organization had always been following the PSA Handbook.
- .05 Because of the time and costs associated with applying retroactively particular standards in the PSA Handbook, the ED proposes government organizations be provided exemptions as to whether they apply certain aspects of particular standards either retroactively or prospectively.
- .06 Additionally, when adopting particular PSA standards retroactively, it is not appropriate for a government organization to update, with the benefit of hindsight, certain decisions or accounting estimates made by the government organization at the time of the transaction or event. When retroactive application is not appropriate, the ED proposes exceptions be provided requiring government organizations to not revisit certain estimates or decisions previously taken and for such standards to be applied prospectively.
- .07 For the purpose of preparing this ED, a comparison of the standards in the PSA Handbook and those in the CICA Handbook – Accounting was performed to identify the major differences a government organization would encounter when transitioning from the CICA Handbook – Accounting to the PSA Handbook. Other first-time adoption standards including FIRST-TIME ADOPTION, CICA HANDBOOK – ACCOUNTING Section 1500, of the accounting standards for private enterprises and International

Financial Reporting Standards (IFRS) 1 *First-time Adoption of International Financial Reporting Standards* were also reviewed to ensure completeness of this ED.

Recognition, measurement and presentation

- .08 The following paragraphs provide the rationale for certain exemptions and exceptions relating to the adoption of the PSA Handbook by government organizations.

Exemptions from other standards

Discount rate used in actuarial valuation

- .09 For a defined benefit plan, under EMPLOYEE FUTURE BENEFITS, CICA HANDBOOK – ACCOUNTING Section 3461, the discount rate used to determine the accrued benefit obligation is by reference to high-quality corporate bonds. RETIREMENT BENEFITS, Section PS 3250, allows the discount rate used to be either by reference to its plan asset earnings or by reference to its cost of borrowing. Retroactive application of the PSA Handbook would require a government organization to complete an actuarial valuation at the transition date.
- .10 Rather than requiring an actuarial valuation at the transition date, the ED proposes that an exemption be provided that allows government organizations to adjust their discount rate at their next actuarial valuation, or within three years of the transition date, whichever is sooner. This would allow government organizations to adjust the discount rates they use on their next regularly scheduled actuarial valuation rather than be required to incur an additional actuarial valuation on adoption of the PSA Handbook.

Recognition of actuarial gains and losses

- .11 For a defined benefit plan, under EMPLOYEE FUTURE BENEFITS, Section 3461, actuarial gains and losses are recognized either in net income using the “corridor” approach or immediately. RETIREMENT BENEFITS, Section PS 3250, requires these gains and losses to be recognized in surplus/deficit in a rational and systematic manner over the expected average remaining service life. Retroactive application would require a government organization to go back and determine its actuarial gains and losses for each year since the inception of the pension plan in order to determine the unrecognized gains or losses at the date of transition to the PSA Handbook.
- .12 Due to the time and cost associated with retroactive application, the ED proposes an exemption allowing a government organization to recognize all actuarial gains and losses as realized at the date of transition and to adopt the requirements of RETIREMENT BENEFITS, Section PS 3250, regarding the recognition of actuarial gains and losses on a go-forward basis.

Accounting for business combinations

- .13 While there is no specific Section in the PSA Handbook on business combinations as exists with BUSINESS COMBINATIONS, CICA HANDBOOK – ACCOUNTING Section

1581, acquisitions are addressed in ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510. On a conceptual basis, the accounting for business acquisitions is similar under both the PSA Handbook and the CICA Handbook – Accounting. However, the detailed requirements for business combinations do vary. Retroactive application would require a government organization to go back to all prior business combinations and to review the identified assets and liabilities and the values assigned to them relative to the PSA requirements.

- .14 Due to the time and cost associated, the ED proposes an exemption allowing government organizations to apply ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, retroactively or prospectively, with the exception of paragraph PS 2510.23, which requires purchase premiums to be expensed. A government organization may choose to apply Section PS 2510 retroactively, for example, if the information required is readily available and the acquisition occurred recently.

Investments in government business enterprises (GBEs)

- .15 INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, requires an investment in a GBE to be accounted for under the modified equity method. Under the modified equity method, the accounting principles of the GBE are not adjusted to conform with those of the controlling entity. Alternatively, under SUBSIDIARIES, CICA HANDBOOK – ACCOUNTING Section 1590, holdings of a GBE by a government organization would be accounted for by consolidation. To comply with retroactive application with restatement, a government organization would be required to recalculate its investment balance in GBEs using the modified equity method beginning from the time of acquisition of the investment. Due to the potential time and cost associated with recalculating this balance, the ED proposes an exemption allowing the modified equity method to be applied retroactively or prospectively.
- .16 The investment in GBE 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 GBE financial statements on the date of transition as calculated under the CICA Handbook – Accounting.
- .17 While it is not expected that many government organizations transitioning to the PSA Handbook will hold investments in GBEs, the exemption proposed in the ED is considered to be appropriate due to the time and effort that would be associated with applying INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, retroactively with restatement. A government organization would have the option to apply Section PS 3070 retroactively or prospectively. A government organization may choose to apply Section PS 3070 retroactively, for example, if the required information is available and the acquisition occurred recently.

Government business partnerships

- .18 GOVERNMENT PARTNERSHIPS, Section PS 3060, requires a government organization holding a government business partnership to account for its share of the partnership on a

modified equity basis rather than through proportionate consolidation as required under INTERESTS IN JOINT VENTURES, CICA HANDBOOK – ACCOUNTING Section 3055. To comply with retroactive application with restatement on adoption of the PSA Handbook, a government organization would be required to recalculate the partnership balance using the modified equity method beginning from the time of acquisition of the partnership. Due to the potential time and cost associated with recalculating this balance, the ED proposes an exemption allowing the modified equity method to be applied retroactively or prospectively.

- .19 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 financial statements on the date of transition as calculated under the CICA Handbook – Accounting (i.e., the January 1, 2010 government business partnership balance in the financial statements of a government organization with a December 31 year end would be calculated using December 31, 2009 or January 1, 2010 financial statements for the government business partnership).
- .20 While it is not expected that many government organizations transitioning to the PSA Handbook will hold partnership interests in government businesses (GBEs), the exemption is considered to be appropriate due to the time and effort that would be associated with applying GOVERNMENT PARTNERSHIPS, Section PS 3060, retroactively with restatement. Adopting this requirement retroactively would require a government organization to go back and determine whether any inter-organizational balances and transactions relating to its holdings of government business partnerships were eliminated that should not have been under the modified equity method. A government organization may choose to apply Section PS 3060 retroactively or prospectively. A government organization may choose to apply Section PS 3060 retroactively if the required information is available and the acquisition occurred recently, for example.

Exceptions to retroactive application of other standards

Hedge accounting

- .21 FOREIGN CURRENCY TRANSLATION, Section PS 2600, allows synthetic instrument accounting to be used by a government organization when hedging of a foreign currency risk. Retroactive application would allow a government organization to go back over previous non-designated hedge transactions to see if they comply with the PSA standards for hedge accounting.
- .22 An exception is proposed in the ED as it is not intended that government organizations adopting the PSA Handbook to retroactively designate as a hedge, transactions entered into before the transition date. Designated hedging relationships entered into prior to the transition date should continue to be accounted for as a hedge if they meet the criteria in FOREIGN CURRENCY TRANSLATION, Section PS 2600.

Tangible capital asset (TCA) impairment

- .23 Under TANGIBLE CAPITAL ASSETS, Section PS 3150, TCA impairment is based on service potential while the requirements of IMPAIRMENT OF LONG-LIVED ASSETS, CICA HANDBOOK – ACCOUNTING Section 3063, are based on economic recoverability of a long-lived asset. Retroactive application of Section PS 3150 would allow a government organization adopting the PSA Handbook to review prior write-downs taken on an economic recoverability basis to consider instead whether service potential was impaired and with the benefit of hindsight.
- .24 It is not considered appropriate for a government organization to revisit prior write-downs relative to the requirements of TANGIBLE CAPITAL ASSETS, Section PS 3150. The ED proposes an exception that Section PS 3150 be applied prospectively from the date of transition by a government organization. If write-downs of TCAs are required under the PSA Handbook, these write-downs would be recorded on a go-forward basis.

Estimates

- .25 Balances and transactions in financial statements often reflect management's best estimates based on information available at that time. It is important 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.
- .26 The exceptions for estimates provided in the ED are consistent with those provided in both FIRST-TIME ADOPTION, Section 1500, and IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The exceptions are as applicable to government organizations adopting the PSA Handbook as they are for entities adopting either IFRSs or the accounting standards for private enterprises, for example.

Other standards considered

Sick-pay benefits that do not vest

- .27 Under POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255, an obligation for sick-pay benefits that accumulate but do not vest should be recorded unless circumstances indicate that it is not significant or may not justify an accrual. Under EMPLOYEE FUTURE BENEFITS, Section 3461, an entity is not required to accrue a liability for sick-pay benefits that accumulate but do not vest. Retroactive application of the PSA Handbook would require a government organization to reassess the appropriateness of recording sick-pay benefits that do not vest on transition to the PSA Handbook.
- .28 No exemption or exception is being proposed in the ED as sick-pay benefits should be accrued under the PSA Handbook and government organizations that adopt the PSA Handbook should comply with this requirement. This is considered an important requirement in the PSA Handbook.

Foreign currency translation

- .29 FOREIGN CURRENCY TRANSLATION, Section PS 2600, requires a government organization to recognize a foreign exchange gain or loss relating to a long-term foreign currency denominated monetary item and to defer and amortize the gain or loss to revenue/expense over the remaining life of the monetary item. FOREIGN CURRENCY TRANSLATION, CICA HANDBOOK – ACCOUNTING Section 1651, requires no deferral and amortizing of these gains and losses but instead the gains and losses are immediately recognized in income. Retroactive application of the PSA Handbook would require a government organization to set up a deferred foreign currency gain or loss for each of their long-term monetary items based on the difference between the exchange rate at the inception of the long-term monetary item and the exchange rate on the transition date to the PSA Handbook.
- .30 No exemption or exception is being proposed in the ED regarding foreign currency translation. Applying the PSA Handbook retroactively on this matter is not considered to require excessive time and effort by a government organization. Providing an option for government organizations as to whether to apply the requirements of FOREIGN CURRENCY TRANSLATION, Section PS 2600, on a retroactive or prospective basis is also considered to be susceptible to manipulation of results based on whether a deferred gain or loss on long-term foreign currency denominated monetary item exists at the transition date. Recording a deferred gain or loss relating to a long-term foreign currency denominated monetary item is a requirement of the PSA Handbook that should be adhered to on the adoption of the PSA Handbook by government organizations.

Accounting for intangibles and goodwill

- .31 Intangibles (with the exception of software) are not recognized under FINANCIAL STATEMENT CONCEPTS, Section PS 1000. Goodwill (also referred to as a purchase premium) under ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510, is expensed immediately although when in relation to an investment in a GBE, the balance is reflected in the investment balance calculated under the modified equity method. GOODWILL AND INTANGIBLE ASSETS, CICA HANDBOOK – ACCOUNTING Section 3064, allows capitalizing and amortizing of intangibles and the capitalizing of goodwill. Retroactive application of the PSA Handbook would require these balances, on transition to the PSA Handbook, to be written off.
- .32 Not writing off the intangible and goodwill balances on adoption of the PSA Handbook would result in carrying forward legacy balances. The PSA Handbook does not provide guidance on the accounting for the balances that would exist on a government organization's financial statements for a considerable period of time. Government organizations would have one set of requirements for legacy balances and another for on-going transactions regarding intangibles and goodwill.
- .33 Therefore, no exemption or exception is being proposed in the ED regarding the accounting for intangibles and goodwill as both balances (other than software) are

expensed under the PSA Handbook and government organizations that adopt the PSA Handbook should comply with this requirement on a retroactive basis.