Government Transfers Exposure Draft: Backgrounder

The accounting treatment of government transfers is currently set out in PS 3410 of the Public Sector Accounting Handbook. PS 3410, *Government Transfers*, was issued when governments were applying the modified accrual basis of accounting. When PSAB approved the change to full accrual accounting, including TCA accounting (PS 3150), governments identified a need for additional guidance and clarification in certain areas to ensure consistent interpretation of the intent and requirements of Section PS 3410.

The areas requiring additional guidance and clarification include:

- recognition of multi-year funding provided by governments to outside organizations;
- the nature and level of authorization required for recognition of transfers by recipient and transferring governments;
- the effects of stipulations on recognition of transfers by recipient and transferring governments;
- recognition of transfers for capital purposes and transfers of tangible capital assets.

A PSAB task force has been working since 2002 to produce a revised version of PS 3410 that addresses these issues. This task force has produced three different exposure drafts on this subject, the most recent of which was released in May of 2010. The deadline for comments on this re-exposure draft is September 15, 2010. For information on previous drafts, or to view the current re-exposure draft, see “Additional Resources” below.

A consensus has been reached on a variety of issues. The following questions are set out in the draft:

> 1. Do you agree with the proposals for recipient government recognition of capital transfers received or receivable? If not, why not?
>
> 2. Do you agree that the standard should apply to fiscal years beginning on or after April 1, 2012? This would mean an effective date of fiscal years beginning on or after January 1, 2013 for most local governments.
>
> 3. Do you have any have new issues or concerns to raise with the other proposals in the document or feel strongly that the Board should reconsider its position on any other proposals?

This backgrounder focuses only on the first question as it remains the main issue where there is no consensus.

It should be noted that the exposure draft deals with government transfers for governments that make transfers as well as those that receive them. Municipalities are usually recipients of transfers from the provincial or federal governments. Therefore, particular attention should be paid to the rules related to reporting transfers by recipient governments. However, many municipalities also provide transfers to cultural or community groups for a variety of reasons. Consequently, you should also review the rules related to reporting transfers that will apply to governments making transfers.

Recent Treatment of Capital Transfers (Prior to 2009)

PS 3410, as it currently stands, makes no distinction between operating transfers or grants to acquire tangible capital assets. PS 3410.07 sets out three criteria for recognizing government transfers in financial statements:

Government transfers should be recognized in a government's financial statements as expenditures or revenues in the period that the events giving rise to the transfer occurred, as long as:

a) *the transfer is authorized;*
b) *eligibility criteria, if any, have been met by the recipient; and*
c) *a reasonable estimate of the amount can be made.*

The basis for determining the amount recognized for any particular transfer should be applied consistently from year to year. Judgment will be required to account for transfers in a manner that best reflects the substance of the underlying events rather than the form or funding pattern. [NOV. 1990]

With regard to capital projects, prior to 2009, municipalities typically recorded capital grants as deferred revenue on the statement of financial position and recognized these amounts as current revenue on the statement of financial activities as expenditures on the project were made. In this way, revenues were matched by corresponding capital expenditures over the construction period of the project.

Post 2008, the cost of tangible capital assets are capitalized and reported on the Statement of Financial Position. The cost is amortized over the useful life of the TCA and reported as an expense on the Statement of Operations. However, under PS 3410, the municipality would still recognize the capital grants as current revenue. In short, the Statement of Operations does not show the expenditure for the asset (the amount paid to acquire the asset) but only the amortization (the amount of the asset consumed or used that year). Thus matching revenues with construction expenditures over the construction period is no longer appropriate. This may result in a surplus being reported in one year when the capital grant is recognized and deficits in subsequent years when the associated TCA is amortized to expense.

Transfers Under Exposure Draft 2

PSAB proposed in the 2009 Re-exposure Draft to adopt an explicit exception to the conceptual framework for accounting for capital transfers received. A capital transfer or a transfer of a tangible capital asset would be recognized as a deferred capital contribution (DCC) when the transfer was authorized and recipients met any criteria that the transferor set before it provides the transfer. The DCC would be recognized in revenue when the related tangible capital asset is recognized in expenses (for example, as the asset is amortized/depreciated). DCCs would be reported on the statement of financial position separate from and below non-financial assets. This proposal was considered an exception to the framework because the DCCs are treated as if they are a liability even though they do not meet the definition of a liability. This proposed treatment by PSAB was in response to comments received from constituents that were concerned about the volatility created when capital grants were recognized as revenue in the one year and the expense (amortization) was recognized in subsequent years. This was of particular concern to those governments that have balance budget legislation.

Responses to the second exposure draft can be seen by following the link in “Additional Resources” below. The following table summarizes the responses received with regard to the reporting of capital transfers.

Table 1

Type	#	Yes	No	?
Senior Government Controller	**12**	**5**	**3**	**2**
Legislative Auditor	**7**	**4**	**2**	
Local Government (BC 34, ON 10, SK 1)	**45**	**3**	**41**	**1**
CA Firm	**6**	**3**	**2**	**1**
Other	**6**	**3**	**2**	**1**
Total	**76**	**18**	**50**	**5**

As is evident from the Table, there was a lack of consensus on the proposed treatment of capital transfers. The MFOA did provide comments to PSAB on the proposals. Municipalities who responded were clearly against the proposals. A summary of the issues raised by local governments included the following.

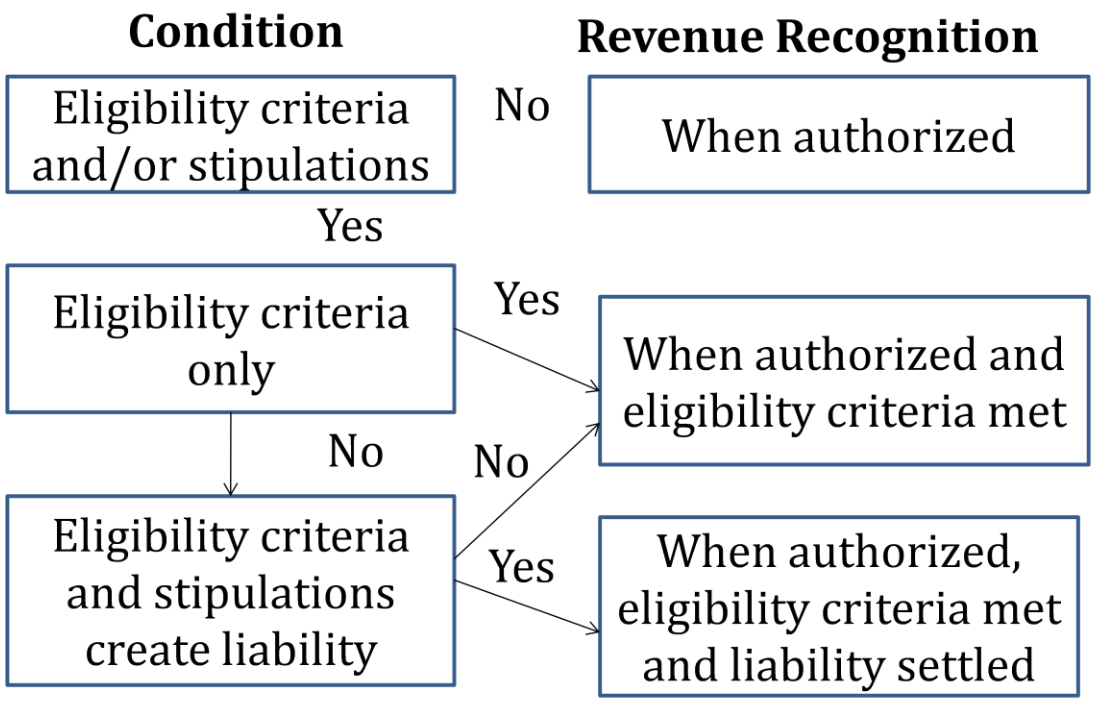
1. The concept of DCCs is a departure from the conceptual framework that is not warranted.
2. Administratively Demanding. Capital transfers would have to be tracked by asset over the useful life of the asset. This requirement would be even more demanding where assets are accounted for on a component basis rather than a whole asset basis.
3. Inconsistent Treatment of Different Revenues. An asset could be partially financed from development charge receipts as well as a capital transfer from another level of government. DCCs would require the grant to be brought into revenue as the asset is expensed, but the development charges would be brought into revenue at the time they are received. Different accounting treatment for revenues for the same asset is both confusing and unhelpful to users of financial statements.
4. Inconsistent Treatment Depending on Nature of Stipulations

Treatment of Capital Transfers in Exposure Draft 3

The third exposure draft takes a different approach than the second. The new draft treats both operating and capital grants the same. The concept of Deferred Capital Contributions has been removed. Proposed sections PS 3410.16 – PS 3410.18 determine the rules for reporting of all grants.

> .16 *A transfer without eligibility criteria or stipulations should be recognized as revenue by a recipient government when the transfer is authorized as described in paragraph PS 3410.33.*
>
> .17 *A transfer with eligibility criteria but without stipulations should be recognized as revenue by a recipient government when the transfer is authorized as described in paragraph PS 3410.33 and all eligibility criteria have been met.*
>
> .18 *A transfer with or without eligibility criteria but with stipulations should be recognized by a recipient government as revenue in the period the transfer is authorized as described in paragraph PS 3410.33 and all eligibility criteria have been met, except when and to the extent that the transfer gives rise to an obligation that meets the definition of a liability for the recipient government in accordance with LIABILITIES, Section PS 3200.*

The sections require a set of decisions to be made that are summarized in the following decision-making flow chart.[1]



What You Should Do and Why

It can be seen from Table 1 above that the DCC approach to reporting capital grants was supported by a significant number of senior government officials (controllers, auditors general). It is our understanding that these organizations will continue to support the proposed approach to recognizing capital transfers in RE-ED 2. It may be a mistake to assume that exposure draft 3 is what PSAB will adopt later this year. Since this is still a very active debate, it is important that you make your voice heard on this issue and send your comments to PSAB. An electronic questionnaire for this exposure draft is available on the PSAB website (click here).

Additional Resources

- Status
- Plain language document on Third Re-exposure Draft
- Issues Analysis on Third Re-exposure Draft
- Responses to Second Re-exposure Draft
- Second Re-exposure Draft
- Plain language document on Second Re-exposure Draft
- Re-exposure Draft 2 (April 2007)
- Exposure Draft 1 (August 2006)

[1] For a discussion of the meaning of "eligibility criteria" and "stipulations," see the proposed PS 3410.08, which says in part: **Eligibility criteria** describe who a recipient must be or what it must do in order to be able to get a government transfer. **Stipulations** describe how a recipient must use transferred resources or the actions it must perform in order to keep the transfer.[1]