Public Sector Accounting Standards Update

To: Audit Committee

Date: 28 May, 2019

Report No.: 05-19-3640

Strategic Directions

- Allocate Human and Financial Resources Strategically to Support Student Needs

Recommendation

It is recommended that the presentation of the Public Sector Accounting Standards Update be received.

Context

To make the Committee aware of nuances in public sector financial statements as well as new and upcoming changings to Public Sector Standards, including, but not limited to, statement presentation, financial instruments and asset retirement obligations.

Action Plan and Associated Timeline

For reporting purposes only.

Resource Implications

Not applicable.

Communications Considerations

Included in public Audit Committee minutes.

Board Policy and Procedure Reference(s)

O.Reg 361/10 is applicable.

Appendices

- Appendix A: Understanding School Board Financial Statements and External Audit
- Appendix B: Toronto District School Board – Accounting Standards Update

From

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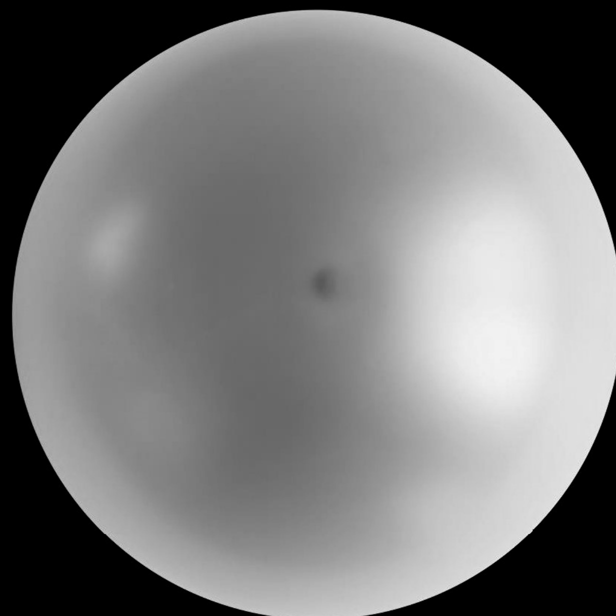
- **Appendix A**



Toronto District School Board – Understanding School Board Financial Statements and the External Audit

May, 2019

Audit & Assurance

Role and Accountabilities of a School Board

Duties related to the Financial Reporting Process [ON Regulation 361/10 9(1)]

- To re iew the School Board's inan ial statements (including accounting practices, complex & unusual transactions, material judgments & estimates, and departures from generally accepted accounting principles)
- To review the results of the external audit
- To recommend, to the Board of Trustees, the approval of the annual audited financial statements
- To review matters that the external auditor is required to communicate to the Audit Committee under generally accepted auditing standards
- To review with the external auditor material written communications

Accounting Standards for School Boards

- School Boards are required to follow Public Sector Accounting Standards (PSA standards) established by the Public Sector Accounting Board (PSAB) of the Canadian Professional Accountants Canada (CPA Canada).
- PSAB has the authority to set accounting standards for the public sector. That authority means that PSAB sets generally accepted accounting principles (GAAP) for the public sector (e.g. governments and government organizations).
- The Government may also direct school boards to follow certain regulations established through legislation.

Financial Reporting Overview – Why PSA?
Unique characteristics of a School Board

Unique Characteristic	Reporting Implications
School Board's goal is to provide services, not make a profit	Net cost of services should be reported. The net economic resources (accumulated surplus/deficit) available to use in providing future services should be reported
Tangible capital assets are different in nature from those held by a business (i.e. they represent service capability, rather than future cash inflows)	Financial assets and non-financial assets should be reported separately on the Statement of Financial Position
Capital spending may not focus on maximizing financial return but on achieving public objectives	Capital spending and its effect on net debt must be highlighted in the financial statements
School Board's budge is part of accountability cycle	Actual-to- budget comparisons should be provided in financial statements. Original budget should be disclosed on Statement of Financial Operations and the Statement of Changes in Net Debt

Financial Reporting Overview (continued)

EFIS

- Education Financial Information System (EFIS) contains significantly more detail than summary financial statements, including grant calculations and supplementary information important for funding decisions

General Purpose Financial Statements

- The general purpose summary financial statements are required to be prepared in accordance with PSA standards and relevant regulations and are required to be audited
- Required statements are as follows:
  - Statement of Financial Position
  - Statement of Operations
  - Statement of Change in Net Debt
  - Statement of Cash Flows
- Notes to financial statements are also required.

Toronto District School Board

Statement of Financial Position

as at August 31, 2018

Financial Assets	2018	2017
Cash & temporary investments	**277,540**	162,751
Due from City of Toronto	**226,340**	238,262
Accounts receivable	**25,990**	22,011
Accounts receivable - Province of Ontario	**603,688**	562,533
Funds on deposit	**102,245**	105,330
Other assets	**14,735**	16,583
Total financial assets	**1,250,538**	1,107,470
Liabilities		
Short-term borrowing	**150,000**	66,000
Accounts payable and accrued liabilities	**302,073**	286,775
Due to Province of Ontario	**40,336**	29,606
Deferred revenue	**169,173**	144,094
Deferred capital contributions	**2,336,922**	2,078,657
Retirement & other employee future benefits payable	**347,837**	362,419
Net long-term debt	**400,615**	420,950
	3,746,956	3,388,501
Net Debt	**(2,496,418)**	(2,281,031)
Non-financial assets		
Tangible capital assets	**2,445,337**	2,174,210
Prepaid expenses and supplies	**9,997**	9,377
	2,455,334	2,183,587
Accumulated deficit	**(41,084)**	(97,444)

Prior year comparatives are required on Statement of Financial Position

- Assets that can be used to discharge existing liabilities or finance future operations
- No distinction between current and long-term financial assets

- All liabilities are reported
- No distinction between current and long-term liabilities

Key indicator
Difference between financial assets and financial liabilities represents future revenue required to pay for past transactions

Assets available for provision of services typically not used for discharging existing liabilities or financing future operations

Key indicator
- Represents school boards net economic resources
- Amount by which all assets fall short of all liabilities

Toronto District School Board

Statement of Operations

Year ended August 31, 2018

Revenue	Budget	2018	2017
Provincial grants			
Grants for student needs	**2,904,999**	**2,901,497**	2,809,985
Other	**45,653**	**82,682**	60,819
Federal grants and fees	**25,000**	**21,855**	20,950
Other fees and revenues	**96,505**	**113,926**	109,799
School fundraising	**40,000**	**43,987**	43,447
Amortization of deferred capital contributions	**129,043**	**153,340**	128,369
	3,241,200	**3,317,287**	3,173,369

Expenses			
Instruction	**2,556,746**	**2,561,674**	2,460,777
Administration	**82,336**	**81,101**	76,258
Transportation	**61,698**	**65,046**	62,394
School operations and maintenance	**303,704**	**308,002**	311,166
Pupil accommodation	**193,220**	**203,272**	182,175
Other programs	**4,471**	**(405)**	4,067
School funded activities	**40,000**	**42,237**	42,079
	3,242,175	**3,260,927**	3,138,916

Annual (deficit) surplus	**(975)**	**56,360**	34,453
Accumulated deficit, beginning of year	**(121,078)**	**(97,444)**	(131,897)
Accumulated deficit, end of year	**(122,053)**	**(41,084)**	(97,444)

Prior year comparatives are presented as well as original approved budget (in PSA format)

Revenues recorded by significant type

- Expenses reported by function or major program
- Note disclosure required to report expenses by object (salaries, supplies)

Key indicator
- Shows whether revenues of period were sufficient to cover expenses of the period
- Reports accumulated deficit (surplus) at the beginning and end of the period

Toronto District School Board
Statement of Change in Net Debt
Year ended August 31, 2018

	Budget	2018	2017
Annual surplus		**56,360**	34,453
Acquisition of tangible capital assets		**(433,869)**	(263,552)
Amortization of tangible capital assets		**154,768**	129,795
Net book value of tangible capital asset disposals		**2,222**	—
Net book value of tangible capital assets reclassified as properties held for sale during the year		**5,752**	—
		(214,767)	(99,304)
Acquisition of inventories of supplies		**(9,363)**	(9,041)
Acquisition of prepaid expenses		**(7,362)**	(6,851)
Consumption of inventories of supplies		**9,321**	8,973
Use of prepaid expenses		**6,784**	6,222
Change in net debt		**(215,387)**	(100,001)
Net debt, beginning of year		**(2,281,031)**	(2,181,030)
Net debt, end of year		**(2,496,418)**	(2,281,031)

This represents the change in future revenue requirements.

Prior year comparatives are presented as well as original approved budget (in PSA format. Note that TDSB does not provide budget numbers on this statement.

Shows the TCA impact on the difference between surplus for the period and change in net debt

Shows other non-financial assets impact on the difference between surplus for year and change in net debt

Shows whether revenues of the period were sufficient to cover spending of the period. This represents the change in future revenue requirements

Financial Reporting Overview

Statement of Cash Flows

- Reports how the Board financed its activities during the period and met its cash requirements by reporting changes in cash and cash equivalents

External Auditors

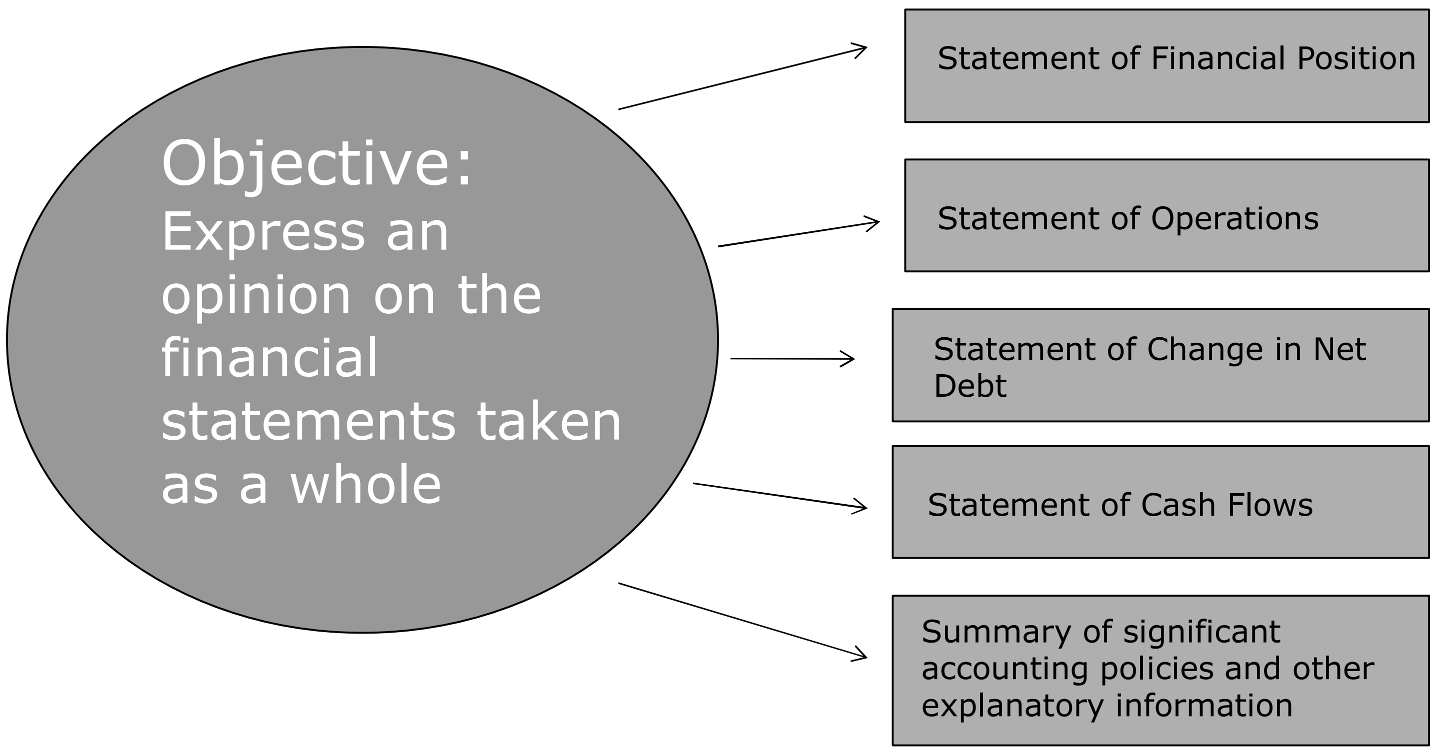
Du ies related to Board's External Au itor

[ON Regulation 361/10 9(4)]

- To review the performance of the external auditor and make recommendations to the Board on the appointment, replacement or dismissal of the external auditor and on the fee and fee adjustment for the external auditor
- To re iew the external au itor's au it plan
- To review and confirm the independence of the external auditor
- To meet on a regular basis with the external auditor and discuss important matters
- To resolve any disagreements between management and the external auditor about financial reporting
- To recommend to the Board a policy designating services that the external auditor may perform for the Board and, if the Board adopts the policy, to oversee its implementation (i.e. monitor independence)

Source: ON regulation 361/10

Objective of External Audit



Responsibilities of External Auditor Related to Internal Controls

- In assessing audit risk, internal controls relevant to the preparation of the financial statements must be assessed by the auditor
- The review and testing of internal controls is carried out in order to assess risk and design relevant and appropriate audit procedures but not to express an opinion on the effectiveness of internal controls
- Internal control deficiencies identified during the course of the audit, which are considered significant, must be communicated to management and the Audit Committee
- An audit designed and executed in accordance with Canadian Auditing Standards may not detect material fraud

Generally Accepted Auditing Standards (GAAS)

- A set of systematic standards and guidelines now referred to as Canadian Auditing Standards (CASs)
- An audit performed in accordance with GAAS is designed to provide reasonable assurance that the Financial Statements, taken as a whole, are free from material misstatement
- CAS's do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with GAAS is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Generally Accepted Auditing Standards GAAS (continued)

GAAS	Audit Committee Oversight
Engagement team must have the appropriate competence and capabilities to perform the audit in accordance with professional standards	Review experience of the lead partner and senior members of audit team and assess their qualifications
Audit should be perform with due care and objective state of mind	Mo itor au itor' independence
The work should be adequately planned	Discuss and review the proposed audit plan
A sufficient understanding of internal control should be obtained in order to assess audit risk and design appropriate audit procedures	Review and understand the extent of au itor's reliance o internal control in the proposed audit plan
Sufficient appropriate audit evidence should be obtained	Ask the auditor whether management has placed any restrictions on the audit

Generally Accepted Auditing Standards GAAS (continued)

GAAS	Audit Committee Oversight
Th independent au itors’ report (the report) should identify the title of each statement that comprises the financial statements and reference the summary of accounting policies and notes and should distinguish between responsibilities of management and those charged with governance as well as the responsibilities of the auditor	Review the formal written representations that management has provided to the external auditor
The report should desc ibe the scope of au itor’s examination	Ensure that the scope as set out in the plan is reflected in the report
Report should contain an expression of opinion or an assertion that an opinion cannot be expressed	Re iew and understand the au itor’s opinion
The opinion should indicate that the financial statements are prepared, in all material respects, in accordance with the appropriate financial reporting framework	Understand the critical accounting policies, significant estimates and judgments made by management as well as the applicable financial reporting framework under which management has prepared the financial statements

Sample - Independent Auditor's Report

To the Board of Trustees of
Toronto District School Board

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Toronto District School Board (the "Board"), which comprise the consolidated statement of financial position as at August 31, 20XX, and the consolidated statements of operations, change in net debt and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements of the Board for the year ended August 31, 20XX are prepared, in all material respects, in accordance with the basis of accounting described in Note 1(a) to the financial statements.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Board in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

Without modifying our opinion, we draw attention to Note 1(a) of the financial statements which describes the basis of accounting used in the preparation of these financial statements and the significant differences between such basis of accounting and the Canadian public sector accounting standards. Our opinion is not modified in respect of this matter.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of the financial statements in accordance with the basis of accounting described in Note 1(a) to the financial statements, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Board's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Board or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Board's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Sample - Independent Au itor’s Report (con inued)

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the ircumstances, but not for the purpose of expres ing an o i ion on the effec iveness of the Board’ internal control.

  Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the approp iateness of management’s use of the g ing concern ba is of accoun ing and, based on the au it e idence obtained, whether a mate ial uncert inty e ists related to events or con i ions that may cast ig i icant doubt on the Board’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our au itor’s report to the related isclosure in the inan ial statements or if such isclosures ar inadequate, to mo ify our opinion. Our conclu ions are based on the au it e idence obt ined up to the date of our au itor’s repor .
  conditions may cause the Board to cease to continue as a going concern.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Board to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

(To be signed Deloitte LLP)

Chartered Professional Accountants
Licensed Public Accountants
Date of the report

Key Phases of the External Audit

Phase	Audit Committee Deliverable
• Agreement on engagement terms	Master Services Agreement
• Initial Planning	
– Understand business and accounting processes (including IT) – Identify engagement risks – Determine materiality – Identify material accounts, transactions and disclosures – Identify and assess risk of material misstatement (including fraud risk) – Coordinate activities with external parties	Audit plan document

Key Phases of the External Audit (continued)

Phase	Audit Committee Deliverable
• Perform audit plan	
– Testing of internal controls – Substantive audit procedures – Obtain appropriate audit evidence – Reviews of accounting policies – Test financial statement disclosures	
• Conclude and report	
– Evaluate results of audit work – Asses impact of current and p ior year's errors, if any – Consider disclosure deficiencies – Determine sufficiency of audit scope – Obtain management representations	– Au itors' report on inan ial statements – Audit results document – Independence letter

Au itors' Independence

Why important?

- Essential component of an audit relationship
- Fundamental to accountability
- Required by the Canadian Auditing Standards
- Reporting required through Board Policy

Source: Integrity in the spotlight, 2nd edition

What may Impair Independence?

- Threats
  - Self Interest
  - Self Review
  - Advocacy
  - Familiarity
  - Intimidation
- Safeguards can be applied
- There are specific prohibited services for publicly listed entities
- For other en i ies any ser ices/ac i i ies, where the au ito is ac in in a “management de i ion ma ing capa ity”, are spe i ically pro i ite .

Source: The Canadian Institute of Chartered Accountants, guide to the Canadian independence standard, (2009 update)

Materiality

- Materiality is the magnitude of a misstatement (including an omission) in the financial statements or related disclosures that would affect the judgment of a reasonable person using those statements
- Auditor is responsible for providing reasonable assurance that the financial statements are free from material misstatement
- In approving the audit plan, Audit Committee should consider both the qualitative and quantitative aspects of materiality

Risk of Fraud

Specific inquiries to be addressed by the Audit Committee

- What are Au it Com ittee’s iews about the isks of frau in the en ity.

  Knowledge of any actual, suspected or alleged fraud affecting the entity?
- What role if any, does the Au it Com ittee exer is in the over ight of management’s antifraud programs?

Fraud: Relevant Definitions

Fraud:

an intentional act by one or more individuals among management, those charge with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Fraud risk factors:

events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity commit fraud

Fraudulent financial reporting:

involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.

(Source: CICA Assurance Handbook)

Fraud versus Error

The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

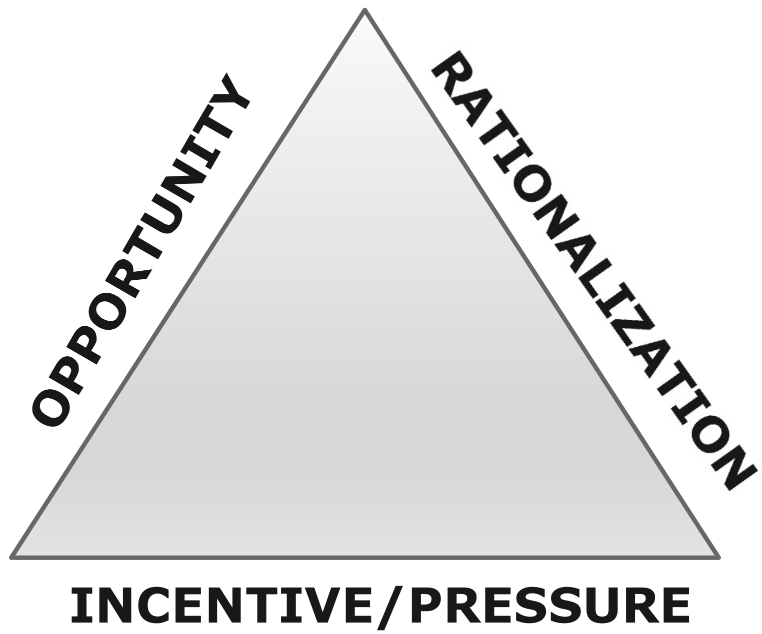
Although fraud is a broad legal concept, for purposes of the auditing standards, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor — misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

Types of Fraud

There are three main types of fraud:

Financial statement fraud	Includes intentional misstatements in or omissions from financial statements
Asset misappropriation	May include cheque forgery, theft of money, inventory theft, payroll fraud, or theft of services
Corruption	May include schemes such as kickbacks, or bribes to influence decision-makers, or manipulation of contracts

The Fraud Triangle



Incentive/Pressure

- Pressure may be real or perceived.
- Pressure is usually created by circumstances the perpetrator is either subject to or perceives him/herself to be subjected to (e.g., personal financial pressures such as a spouse who loses a job, or market pressures to meet financial targets or goals).
- Examples:
  - Status-seeking or status-maintaining needs (lifestyle pressures).
  - Financial problems (debt).
  - Need to meet unrealistic goals set by organization.
  - Need to meet earnings to sustain investor confidence (in a public company environment).
  - Need to meet budget targets.
- There may also b incen ives tha increase the likelihood of fraud (. bonus structure).

Rationalization

The process by which a person committing a fraud legitimizes or justifies the crime is rationalization

T is ofte includes an at itude or feeling of en itlement and/or a belief that "the orga iza ion can affor i .

For example, a perpetrator may rationalize a theft by saying

- I was only borrowing the money.
- I deserve it for all of the extra hours I work
- My employer has been cheating me
- This is only a temporary solution to fix the problem
- I'll pa it back when I can

Opportunity

- Opportunities to commit fraud can manifest themselves in different ways
- If internal controls are inadequate surrounding financial reporting or safeguarding assets, it may be relatively easy for a perpetrator to record fraudulent transactions or steal assets
- Some employees (often within management) may be in a position to override controls which may create opportunities to commit fraud
- There is another consideration for opportunities that is often overlooked -low perception of detection or meaningless consequences to inappropriate behavior within the organization may allow for greater opportunities for fraud to occur than if there is the deterrent element of a high likelihood of detection and severe consequences
- Further, collusion may enable perpetrators to bypass existing controls, rendering those controls ineffective
- Most traditional internal preventative controls are not effective at addressing collusive fraud. Collusive fraud is generally found by detective controls coupled with an understanding of the business and operating environment

Initial Detection of Occupational Frauds

FIG. 56 **What are the most common occupational fraud schemes in Canada?**

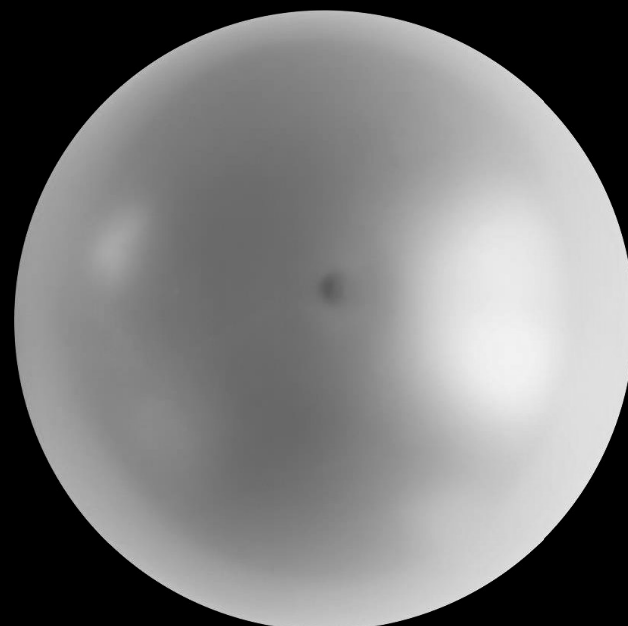
FIG. 57 **How is occupational fraud initially detected in Canada?**

(Source: Report to the Nations - 2018 Global Study on Occupational Fraud and Abuse)

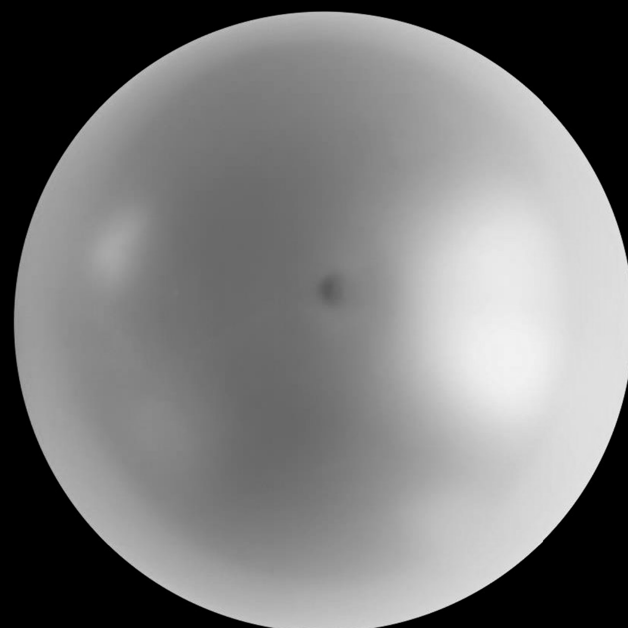
Audit Results Document

- Auditors meet with the Audit Committee to present findings
- Examples of elements of an Audit Results Document:
  - Status of audit, its scope and representations
  - Audit opinion
  - Matters to be communicated to the Audit Committee
  - Results of audit work on significant risk areas
  - Review of areas of judgement and management estimates
  - Summary of unadjusted differences
  - Confirmation of Auditor independence

Thank you!



- **Appendix B**



Toronto District School Board – Accounting Standards Update

May, 2019

Audit & Assurance

Effective dates for new standards
Public sector accounting

Topic	Impact	Effective date
PS 3430 **Restructuring Transactions**	Recognition, measurement, and disclosure of restructuring transactions	Fiscal periods beginning on or after **April 1, 2018** Earlier adoption permitted
PS 1201 **Financial Statement Presentation** PS 2601 **Foreign Currency Translation** PS 3041 **Portfolio Investments** PS 3450 **Financial Instruments**	Recognition, measurement, and disclosure of financial instruments	Fiscal periods beginning on or after **April 1, 2021** Earlier adoption permitted
PS 3280 **Asset Retirement Obligations**	Recognition, measurement and disclosure of asset retirement obligations	Fiscal periods beginning on or after **April 1, 2021** Earlier adoption permitted
PS 3400 **Revenue**	Recognition, measurement and disclosure of revenue	Fiscal periods beginning on or after **April 1, 2022** Earlier adoption permitted

Active Projects

Planned timelines and deliverables

Current projects	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Conceptual Framework				
International Strategy		CP		
Not-for-Profit Strategy		CP		
Public Private Partnerships				ED
Employment Benefits				
Annual Improvements - 2018 - 2019	ED		HB	
Financial Instruments Amendments	ED			

CP: Consultation paper
D: Decision
ED: Exposure Draft
FS: Final Standard
ITC: Invitation to Comment

https://www.frascanada.ca/en/public-sector/projects

Restructuring Transactions

Restructuring Transactions

PS 3430

DEFINITION

A **restructuring transaction** is a transfer of an integrated set of assets and liabilities, together with related program or operating responsibilities, that does not involve an exchange of significant consideration, which is determined primarily based on the fair value of the individual assets acquired and liabilities assumed.

WHY?

There is a wide range of restructuring activities in the Canadian public sector. They include, but are not limited to, amalgamation of entities or operations, boundary alteration between neighboring local governments, transfer of operations or programs from one entity to another and shared services arrangements. Previously, accounting for restructuring transactions was not specifically addressed in the PSA Handbook.

SCOPE

PS 3420 **does not** deal with accounting for:

(a) acquisitions of a group of assets, an operation or an entity (see PS 2510 Additional Areas of Consolidation and PS 3070 Investment in Government Business Enterprises);

(b) contributions of assets or assumption of liabilities (see PS 3410 Government Transfers);

(c) restructuring transactions among related parties (see PS 3420 Inter-Entity Transactions); and

(d) restructuring transactions by the restructuring entity (apply general principles in the PSA Handbook)

Scope of a restructuring transaction

What consideration or compensation?	Significant Exchange	Significant Exchange	Substantial but non exchange	None or nominal	None or nominal
What is transferred?	Asset or group of assets	Assets + liabilities + responsibilities	Assets + liabilities + responsibilities	Assets + liabilities + responsibilities	Only assets or liabilities
Type of transaction	**Asset Purchase**	**Acquisition**	**Restructuring**	**Restructuring**	**Transfer**

Measurement, classification, presentation, and disclosure

Measurement

- Restructuring transactions do not have a purchase cost to establish a new cost basis for the assets and liabilities received by the restructured entity
- As such, the **carrying amount** is the initial measure for assets and liabilities transferred in restructurings

Classification

- Assets and liabilities transferred in a restructuring should be initially classified at the restructuring date based on the accounting policy of the restructured entity

Presentation

- Financial position and results of operations of the restructured entity prior to restructuring date should not be restated

Disclosure

- Sufficient information should be disclosed to enable users to assess the nature and financial effects of a restructuring transaction on the restructured en ity's inan ial po i ion and operations
- Disclosure of information about the restructuring entities or transferred operation prior to restructuring date is encouraged but not required

Asset Retirement Obligations

Asset Retirement Obligation (AROs)

Update – PS 3280

DEFINITIONS

An **asset retirement obligation** is a legal obligation associated with the retirement of a tangible capital asset.

UPDATES TO PSAS

Section PS 3280, Asset Retirement Obligations was released August 2018. The standard is in effect for the fiscal periods beginning on or after April 1, 2021, unless the public sector entity elects to early adopt. PS 3270 Solid Waste Closure and Post Closure Liability standard has been withdrawn, but will remain in effect until adoption.

WHY?

This standard was developed to improve the information provided to users as Public Sector entities previously *only* include acquisition costs of tangible capital assets and did not consider the full cost when setting up an asset; e.g., in 30 years what would it cost to decommission this asset? The new standard will improve consistency in accounting for AROs and provide users and decision makers better information regarding the full cost of a tangible capital asset.

SCOPE

PS 3280 applies to asset retirement obligations associated with **tan i le ca i l assets ("TCA")** controlled by public sector entities that are in **productive use *and* no longer in productive use**. Only **legal obligations**, including obligations created by promissory estoppel, are in scope of this standard.

What is an asset retirement obligation?

A liability for an asset retirement obligation can be incurred due to:

(a) the acquisition, construction or development of a tangible capital asset, or

(b) normal use of a tangible capital asset.

The existence of an agreement, contract, legislation or another legally enforceable obligation is not the event that creates the liability. It is the acquisition, construction, development or the subsequent use of the tangible capital asset that is the obligating event. It is predictable and unavoidable.

Examples of asset retirement obligations

Estimated liabilities associated with:

- Decommissioning of a nuclear power plant
- Removal of asbestos from a building
- Post retirement operation, maintenance and monitoring form part of the ARO
- Retirement of landfills or hospital equipment, such as X-ray or MRI machines
- Other obligations to retire tangible capital assets may arise from contracts or court judgment or promissory estoppel i.e. public commitment

Items that would **not** be asset retirement obligations

Items that would not be asset retirement obligations:

- An unexpected contamination or spill
- Waste or by-products created by tangible capital assets
- Preparing as asset for alternate use or sale
- Improper use of the asset

How do you measure an ARO?
Subsequent measurement

Tangible capital asset

- ARO should increase the carrying amount of the related tangible capital asset (or a component thereof) and a corresponding liability
- ARO for TCA is amortized in a rational and systematic manner
- Review of obligation may change the estimate of the asset

Obligation

- Best estimate of the amount required to settle the obligation
- Review timing, amount, and discount rate
- Passage of time accretion expense
- The carrying amount of a liability for an ARO should be reconsidered at each reporting date

Cash flow

- Cash flow to settle the obligation would typically occur at the end of the useful life of the asset
- Cash flow would draw down obligation that was previously set up

How do you measure an ARO.
Simplified ARO example

Assume that your organization is planning on demolishing a building that contains asbestos in 5 years

The best estimate is that it will cost $100 to remove the asbestos in 5 years

An appropriate discount rate for your organization is 3%

	Obligation balance	Interest expense	Asset balance	Amortization expense	Total expense	Cash flow
Year 0	($86.26)		($86.26)			
Year 1	($88.85)	($2.59)	($69.01)	($17.25)	($19.84)	$0.00
Year 2	($91.51)	($2.67)	($51.76)	($17.25)	($19.92)	$0.00
Year 3	($94.26)	($2.75)	($34.50)	($17.25)	($20.00)	$0.00
Year 4	($97.09)	($2.83)	($17.25)	($17.25)	($20.08)	$0.00
Year 5	$0.00	($2.91)	$0.00	($17.25)	($20.16)	($100.00)
Total		**($13.74)**		**($86.26)**	**($100.00)**	

On recognition

Dr. TCA ARO $86.26

Cr. ARO ($86.26)

Each year

Dr. Accretion Expense xxx

Dr. Amortization Expense xxx

Cr. TCA ARO (xxx)

Cr. ARO (xxx)

On settlement

Dr. ARO $100

Cr. Cash ($100)

Transition options

PS 3280 ARO
Transitional provision

Prospective

PS 3280 Applies to:

- Current and subsequent periods
- Events and transactions after date of adoption
- Any existing obligations as at the date of adoption of the standard

Retroactive

Full retroactive

- Applied to events and transactions from the date of origin

Modified retroactive

- Similar to full
- Assumptions and discount rates using information that is current as of the date of adoption

Asset retirement obligations - Disclosure requirements

Disclosure requirements

- General description of the ARO and Associated TCA
- Amortization Method for ARO
- Basis for estimate of the liability
- Facts and reasons if a reasonable estimate cannot be made
- How funding and assurance provisions (if legally required) are being met
- Estimated Recoveries
- Reconciliation of beginning and ending balances

ARO beginning balance	Liability incurred	Liability settled	Accretion expense	Revisions to estimated cash flows	ARO ending balance

Asset retirement obligations - Implementation considerations

Smooth and accurate implementation of this standard will require strong interaction and communication between Finance, Facilities and Legal. Some considerations are:

Start with a complete TCA Listing

Conclude on whether an ARO exists

Tag assets that could potentially have Asset Retirement Obligations – Investigate

Determine whether there are ARO's for TCA's not recorded

Involve operational stakeholders in determining ARO characteristics

Have you performed a "lessons learned" deb ief from the adop ion of PS 3260 Conta inated ites.

Revenue

Existing revenue standards
PS 3400 – A general purpose standard

PSAS has the following standards, which direct some types of revenues:

- **PS 3410 Government Transfers**
- **PS 3510 Tax Revenue**
- **PS 3450 Financial Instruments**
- **PS 3060 Government Partnerships**
- **PS 3100 Restricted Assets and Revenues**
- **PS 4210 Contributions – Revenue Recognition**
- **PS 3070 Investment in Government Business Enterprises**

General concepts

Contributions that are voluntary and non-reciprocal in nature are specifically scoped out of the standard

Public sector entities generate a variety of non-taxation revenues:

Transactions with Performance Obligations

- Goods or services, are provided to a payor for consideration.
- Create **performance obligations** for a public sector entity (specific benefits with enforceable promises)

Examples:

- User charges and fees for use of public property
  - Community centre hall rental
  - Transit fares
  - Parking fees
- Utility, development & permit charges
- Tuition fees
- Patient revenues from a hospital
- Sale of goods (text books, garbage bins)

Transactions without performance obligations

- Results in increases in economic resources of a public sector entity without a direct transfer of goods or services to the payor
- No performance obligations are present

Examples:

- Fines
- Tickets
  - Parking
  - Speeding
- Penalties

Exchange transactions

Performance obligations

Performance Obligations

- **Enforceable promises** to provide goods or services to a payor as a result of exchange transactions.
- May arise from:
  - A contract negotiated with the payor,
  - Terms set by the public sector entity,
  - Public sector en i ies’ autho ity to grant ights to a good or ser ice
- Performance obligations that meet the definition of a liability, under PS 3200, are present obligations.

Mission or mandate

- The mandate or mission of a public sector entity does not create performance obligations on its own.

Exchange transac ions (cont’d)
Performance obligations

A performance obligation are enforceable promises to provide goods or services to a payor as a result of exchange transactions

Identify all (explicit or implicit) promised goods and services in the contract

Are promised goods and services distinct from other goods and services in the contract?

Separately identifiable

Is the promise to provide the good or service separately identifiable in the context of a contract?

and

Separate benefit

Can the payor benefit from the good or service either on its own or together with other resources that are readily available to the payor?

Yes

Account for as a performance obligation

No

Combine two or more promised goods or services and recognize as a single performance obligation

Measurement and recognition

Measurement

Transactions with performance obligations

- Amount of consideration a public sector entity expects to receive in exchange for promised goods or services, while considering the effects of:
  - Multiple performance obligations
  - Variable consideration
  - Existence of significant concessionary terms
  - Non-cash consideration.

Transactions without performance obligations

- A public sector entity should recognize unilateral revenues at its realizable value

Recognition

Transactions with performance obligations

- Revenue is recognized
  - When the portion of the transaction price allocated to the performance obligation is satisfied and
  - Control of the benefits associated with the goods or services has passed to the payor.
- Recognized at a **Point-in-time** or **Over time**

Transaction without performance obligations

- Revenue is recognized when:
  - A public sector entity has the authority to claim or retain an inflow of economic resources and
  - A past event gives rise to a claim of economic resources

Thank you!