

Public Sector Accounting Discussion Group

Report on the Public Meeting

November 18, 2016

The Public Sector Accounting (PSA) Discussion Group is a discussion forum only. The Group's purpose is to support the Public Sector Accounting Board (PSAB) by enabling discussion in a public venue of issues arising from the application of the CPA Canada Public Sector Accounting Handbook (PSA Handbook). The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of PSAB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of PSAB and is based on discussions during the Group's meeting.

Comments made in relation to the application of the PSA Handbook do not purport to be conclusions about acceptable or unacceptable application of the PSA Handbook. Only PSAB can make such a determination.

Items Presented and Discussed at the November 18, 2016 Meeting

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ITEMS PRESENTED AND DISCUSSED

Section PS 3060: Shared Control

Determining whether the definition of a government partnership is met for a certain situation can be difficult. Much of this difficulty arises when trying to determine whether shared control exists. The submission indicated that Section PS 3060, *Government Partnerships*, does not provide sufficient guidance on its own to assist in this determination.

Scenario

- A contractual arrangement was entered into by 10 municipalities.
- In accordance with the terms of the contractual arrangement, a separate entity was incorporated.
- The contractual arrangement was entered into and the entity formed in order to provide specific municipal services to residents of the 10 municipalities and to share the costs and revenues associated with providing those services (paragraph PS 3060.06(a) is met).
- Each municipality made an equal initial financial investment in the entity and took back a 10 percent interest in the incorporated entity. This initial financial investment was used to construct the infrastructure required to provide the services to the 10 municipalities (paragraph PS 3060.06(b) is met).
- The entity's annual operations are funded by user fees charged to each participating municipality based on usage of the services provided by the entity.
- The entity is run by a board of 10 directors. Each of the 10 municipalities appoints one director who serves for a three year term. Each director has one vote. The board operates in accordance with the terms of the contractual arrangement and holds meetings on a regular basis. The following decisions must be made by unanimous consent:
 - Approval of any significant financial investment required by the municipalities;
 - Approval of any borrowing arrangements into which the entity wants to enter;
 - Approval of any additional municipality that wants to participate in the contractual arrangement in the future;
 - Approval of a change to the contractual arrangement; and
 - Approval to terminate the contractual arrangement.
- All other decisions are required to be made by majority vote of the board members.
- The 10 municipalities share on an equitable basis the significant risks and benefits associated with the operations of the entity (paragraph PS 3060.06(d) is met).

Based on this scenario, the submission indicated that the criteria in paragraphs PS 3060.06(a)-(b) and (d) of the definition of a government partnership are met.

Issue – For the criteria on shared control in paragraph PS 3060.06(c) to be met, what are the essential decisions that would be required to be made by unanimous consent of the board members?

Group members sought and received clarification on various matters before commencing their discussion:

- One Group member noted that in order to have a government partnership there must be shared control and the involvement of all partners in essential decisions. However, clarification was requested as to whether it is possible to have a government partnership if there are no decisions on which agreement by all parties is required. It was clarified that if the vote does not count (i.e., only a majority vote is required), then shared control would not exist.
- It was acknowledged that all three views require professional judgment but also clarified that Views A and B were directive in terms of the specific sources to consider for additional guidance in determining the existence of shared control. In contrast, View C was more open to considering various sources of additional guidance with the sources being tailored to the type of situation under scrutiny.
- One Group member asked if there is any substantive distinction between the phrase in paragraph PS 3060.13: “decisions in areas essential to goals” and the essential types of decisions considered in the indicators of control in Section PS 1300, *Government Reporting Entity*. It was clarified that no distinction between the two is intended.
- A further question was raised regarding how the entity was formed, with the objective of distinguishing the fact pattern under consideration from examples set out in paragraphs PS 3060.17-.18. In particular, it was asked whether in the scenario under consideration there were any previous public or private sector operator(s) for such activities or whether all new infrastructure was built using the cash contributed by individual municipalities. For simplicity, it was clarified that the entity was the result of a new arrangement to provide services not currently provided. Other more complex scenarios are possible.

Three views were considered:

View A – Determining what the essential decisions of the entity are would be considered in the context of the indicators of control in Section PS 1300

View A argues that since there is no specific guidance in Section PS 3060 that assists in determining what these essential decisions would be, it would be appropriate for a municipality to consider the indicators of control in paragraphs PS 1300.18-.19 in determining what the essential decisions of the entity are.

In considering the indicators outlined in paragraphs PS 1300.18-.19 in relation to this scenario, each municipality may determine that it has shared control in this situation. This conclusion arises because:

- the guidance in paragraph PS 1300.18 comprises the more persuasive indicators of control;
- the indicator in paragraph PS 1300.18(b) may be considered to be met;

- the indicator in paragraph PS 1300.18(d) is met,
- while the remaining criteria in paragraphs PS 1300.18(a) and (c) are not considered applicable in this situation.

This conclusion is further supported by the fact that the “other” criteria in paragraphs PS 1300.19(c) and (e) also appear to be met.

Under this view the government partnership definition would be met.

View B – Determining what the essential decisions of the entity are would be considered by also looking to guidance outside of the PSA Handbook

View B indicates that the indicators of control in paragraphs PS 1300.18-.19 are a good starting point for determining the essential decisions of the entity. However, these paragraphs do not specifically consider which decisions most affect the “activities and goals” of the partnership. It asserts that these activities and goals may be considered equivalent to the “relevant activities” of an entity as described in IFRS 10 *Consolidated Financial Statements*. Therefore, this view would take the position that it may be helpful to look outside the PSA Handbook and to the guidance in IFRS 10 when determining the essential decisions of the entity.

Under IFRS 10, when assessing control,¹ the standard requires a determination of the entity’s relevant activities and how decisions about those relevant activities are made. Also under IFRS 10, when an investor is assessing whether it has control over an investee, it only considers substantive rights that it holds. It does not consider “protective rights”. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances, and do not give a party power over an entity to which the rights relate. IFRS 10 also provides guidance on identifying protective rights.

Under this approach, the municipalities in this scenario would not have shared control over the entity since the decisions that require unanimous consent are not substantive decisions about the entity’s relevant activities. Under this view, the definition of a government partnership would not be met.

View C – Determining what the essential decisions of the entity are would be made by using professional judgment

View C argues that reference to the generally accepted accounting principles (GAAP) hierarchy and the application of professional judgment for each individual determination is appropriate to ascertain what source(s) of GAAP might provide additional guidance on the nature of the essential decisions required for shared control to exist. *Generally Accepted Accounting Principles*, paragraph PS 1150.05, would require that an entity use professional judgment that is consistent with the primary sources of GAAP and the conceptual framework when a standard is not specific.

Under this view, each municipality would use its own professional judgment and consider the facts and circumstances of the situation to determine whether the decisions that require unanimous consent are

¹ Determining joint control under IFRS 11 *Joint Arrangements* is based on the same control principles contained in IFRS 10. Additionally, the determination of control in IPSAS 35, *Consolidated Financial Statements*, is also based on the same principles as IFRS 10.

in fact essential decisions of the entity and, therefore, provide the municipality with shared control. Unless an agreement is very specific, under this view, it is possible for there to be diversity in practice as each of the municipalities involved could differ in what they believe the essential decisions of the entity are. As a result, some municipalities could determine they have shared control while others may determine they do not have shared control.

Reference to either Section PS 1300 or IFRS 10, or both, or to other relevant sources that are consistent with the primary sources of GAAP and the conceptual framework may be appropriate. Different guidance may be helpful depending on the specifics of individual scenarios.

Thus, the question of whether an arrangement meets the definition of a government partnership would vary according to the professional judgment of the preparer in relation to whether shared control as required by paragraph PS 3060.06(c) is met, after considering the sources of GAAP determined to be most relevant to the particular scenario by that preparer.

The Group's Discussion

One Group member felt strongly that reference to IFRS 10 would be inappropriate as it might be interpreted as contradicting Section PS 3060. In requiring the consent of all parties to the arrangement for essential decisions, paragraph PS 3060.13 effectively gives a dissenting party a veto and, as a result, power over the operations of the entity. Section PS 3060 would seem to give veto rights to all members regarding essential decisions but only voting rights with respect to non-essential decisions. IFRS 10 makes a distinction between substantive rights and protective rights, with only substantive rights conveying power over an investee and, thus, only substantive rights impacting the determination of control. Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

The Group was most comfortable with View A for the submitted scenario, indicating that help for determining if shared control exists is best made through consideration of the indicators of control set out for the reporting entity in Section PS 1300. This approach would foster internal consistency within Canadian public sector GAAP. In addition, many Group members felt that the details of the contractual arrangement would determine what decisions are essential. Given the private sector focus of IFRS 10, one Group member indicated that a more appropriate external reference would be IPSAS 37, *Joint Arrangements*. But it was clarified that IPSAS 37 is based on IFRS 10 and IFRS 11, *Joint Arrangements*.

One Group member noted that the example in the scenario was fairly generic and simplistic and questioned the genesis of the submission. It was clarified by the representative of the submitting group that it is the identification of those decisions requiring majority vote versus unanimous agreement that is problematic. Sometimes the agreement is vague on this point. Questions have been raised as to whether in the case of partnerships financial and operating decisions are always to be classified as essential. And it was noted that the nature of the guidance in other frameworks, such as IFRSs, IPSASs and accounting standards for private enterprises (ASPE), is fairly consistent, but is different from the PSA Handbook. The submitters' intent was to raise the question as to whether more guidance is needed within the PSA Handbook in order to achieve a more consistent determination of the

existence of shared control in similar circumstances, or alternatively, whether reference to a single source of additional guidance could be identified by the Group.

Section PS 3060 requires accounting for a government partnership using proportionate consolidation. If an investment is not a government partnership, it would be accounted for as a portfolio investment at cost.

Group members discussed the implications when shared control does not exist. For example, when there are partners of disproportionate size; for such arrangements, power sharing and control differentials may exist, calling the “shared” aspect of control of the investee into question. In such cases, there would likely be no shared control. So the entity cannot meet the definition of a government partnership and, therefore, the entity would not, therefore use the PSA Handbook. And the partners would account for their investment as a portfolio investment if they use the PSA Handbook.

The Group ultimately felt that View C was not sufficiently distinct, as professional judgment is always applied in determining the appropriate accounting treatment within GAAP. In complex cases, further guidance may be sought to inform the PSA Handbook position; the relevant other sources of GAAP would be determined by reference to the GAAP hierarchy in Section PS 1150. In addition, some Group members expressed discomfort with the suggestion in View C that different parties to an arrangement might, through the exercise of professional judgment, come to a different determination regarding the existence of shared control and, thus, account for investments in the same arrangement differently.

It was noted that PSAB could consider preparing examples to help in determining whether shared control exists. The increasing use of government partnerships and public private partnerships indicates that the questions relating to this type of determination will grow. PSAB’s Public Private Partnerships project may provide helpful guidance.

Introduction: Scope of the Public Sector

The submission asserted that appropriate accounting framework to be used by subsidiary entities of a controlled not-for-profit organization (NFPO) of government is not clear in the PSA Handbook. It noted that there is diversity in practice in respect of whether the PSA Handbook or accounting standards for not-for-profit organizations of the CPA Canada Handbook – Accounting is applied in preparing an NFPO’s financial statements when that entity is a subsidiary of an NFPO controlled by government. A clear indication of the appropriate framework would impact many entities that are subsidiaries of government organizations. Therefore, the implications are significant as such a determination can affect the scope of the public sector to which the PSA Handbook applies.

Scenario

Hospital A is controlled by a provincial government (the Province) based on the following fact pattern:

- The current Board of Directors of Hospital A is elected by members of Hospital A.
- The Province does not appoint the Board of Directors in the normal course.
- None of the current Board of Directors are appointees of the Province.

- However, current legislation enables the Province to replace the Board of Directors with a “supervisor” when it is in the public interest to do so, and the supervisor exercises all the powers of the Board.
- In addition, at any time one or more hospital board members may be appointed by the Province (by the lieutenant governor, or by regulation) for a three-year term. The number of board members so appointed does not appear to be limited by statute, and therefore, could be sufficient to create a majority of the Board of Directors. Currently no such appointments have been made.

Hospital A applies the PSA Handbook, including the accounting policies available to NFPOs in Sections PS 4200 to PS 4270 (the PS 4200 series).

Hospital A has created a number of other NFPOs, including NFPO X, that fulfil specific functions for the hospital outside of the core healthcare services. For example, NFPO X contains the scientific research operations of the hospital. Other NFPOs may be used to house operations such as managing parking. NFPO X directors are elected by its members, which are defined as the Board of Directors of Hospital A. Under *Reporting Controlled and Related Entities by Not-for Profit Organizations*, paragraph PS 4250.05:

“One organization is presumed to control another entity when it has the right to appoint the majority of the voting members of the other entity’s board of directors. When two organizations have the same board of directors, the presumption is that one organization controls the other.”

Hospital A has determined that control exists and that, combined with significant economic interest between the two entities (significant economic interest is another indicator of control under Section PS 4250), supports the conclusion that NFPO X is controlled by Hospital A. The conclusion that Hospital A controls NFPO X is assumed to be accurate for the purposes of the discussion.

Issue – What GAAP should a controlled NFPO (NFPO X) of a NFPO controlled by government (Hospital A) apply – the PSA Handbook or Part III of the CPA Handbook – Accounting?

Before commencing the discussion, one Group member asked for clarification as to whether the issue relates to subsidiaries² in general or, more specifically, to foundations. It was noted that subsidiaries that provide ancillary services is the focus of the submission and that in the scenario submitted, a foundation is not considered to be a controlled entity of Hospital A. It was also clarified that for the purpose of the discussion controlled entities would not be government business enterprises (GBEs) but would normally be other NFPOs. It was acknowledged that an entity providing ancillary services may be a GBE with a quasi-public objective(s) but that such a scenario was not contemplated in the submission and could be considered separately in a future discussion.

Two views were considered.

View A – NFPO X is in the public sector and should apply the PSA Handbook

² The term “subsidiaries” was used in the private sector sense to mean the entities controlled by a “parent” entity.

View A is based on the argument that Hospital A is a controlled organization of a government and, thus, by virtue of that government control, all subsidiary organizations (such as NFPO X) controlled by Hospital A are also controlled by the government. So, NFPO X would be a government organization as defined in the Introduction to Public Sector Accounting Standards because it is controlled by a provincial government. And as it is an NFPO, it is a government NFPO as defined in the Introduction. Based on the flow chart in Appendix A to the Introduction, government NFPOs must apply the PSA Handbook, either with or without the PS 4200 series.

Control can be indirectly held through another entity and there does not have to be direct mechanisms of control by the top-level government to be able to exercise control. There is an inescapable cascade of control. If the Province controls Hospital A (the parent organization), and Hospital A controls NFPO X (a subsidiary organization), then the Province must, indirectly, control NFPO X too.

View B – NFPO X is not in the public sector and should apply Part III of the CPA Canada Handbook – Accounting

This view argues that NFPO X is not a government NFPO and, thus, the Introduction does not apply to it and neither does the PSA Handbook. So as an NFPO that is not in the public sector, it would apply Part III of the CPA Canada Handbook – Accounting in preparing its financial statements.

This view reaches this conclusion based on three arguments:

- NFPO X is not clearly in the public sector and does not have an accountability relationship with the Province. Unlike Hospital A, the mandate of NFPO X is not healthcare.
- The case that Hospital A is controlled by the Province is not conclusive. The number of factors supporting a control assertion are insufficient and there is a distance and disconnect between the government and NFPO X in terms of the mechanisms of control.
- The terminology in the PSA Handbook regarding subsidiary controlled organizations of controlled entities is not clear and a literal interpretation would require a direct mechanism of control by the Province of NFPO X. A clear indication of PSAB's intent with respect to direct or indirect control does not currently exist.

The Group's Discussion

One Group member noted that the pervasiveness of this question is growing, particularly in the health care sector, in relation to subsidiary organizations of hospitals. Another noted that such entities also exist in relation to indigenous governments. Subsidiary entities are created for funding purposes, for tax advantages or to be incubators for intellectual property development. They are not directly involved in health care or delivering on other government objectives even if they are part of organizations that are directly involved in such delivery.

Another member noted that the PSA Handbook does not make a direct/indirect control distinction and that control is a question of fact. Determining if control exists requires the application of professional judgment based on the definition of control and the substance of the relationship in each case. It is the preponderance of evidence that would be considered in assessing whether an entity controls another

entity. Other Group members agreed, noting the “inescapable cascade of control” mentioned in the submission.

The representative of the submitting group highlighted that the PSA Handbook currently includes the PS 4200 series of standards for government NFPOs and those standards would not mandate the consolidation of all subsidiaries. Some controlled organizations may not be consolidated and only disclosures would be provided in the controlling entity’s financial statements. As a result, many hospitals are not now consolidating entities like NFPO X in their financial statements. Some jurisdictions have required their government NFPOs to apply the PSA Handbook without the PS 4200 series – a choice allowed by the Introduction. Thus, depending on the jurisdiction in which it resides, if it controls NFPO X, Hospital A may or may not consolidate NFPO X in the Hospital’s financial statements.

One Group member indicated that View A is appropriate because the structure of the parent and subsidiary does not matter. Determining the appropriate accounting would look through the structure to the substance of the relationship.

Some Group members raised a concern that View B may focus more on form than substance, on picking away at the details rather than seeing the big picture of the relationship of the entity with government through Hospital A, a controlled government NFPO. It was asserted that an outside observer would see NFPO X as part of Hospital A and part of government. One Group member questioned whether View B is a symptom of disagreement with the PSA Handbook model by entities like NFPO X, and a related preference for the flexibility that allows non-consolidation in Section PS 4250. Some other Group members agreed and reflected that PSAB may need to address the disconnect from government felt by some public sector entities that are structurally further away and distinct from government in terms of how the PSA Handbook model requires them to report their operations.

It was acknowledged that there is strife in the public sector not-for-profit community because some feel the PSA Handbook model does not meet their needs. It was also noted that the nature of entities in this group is diverse and many feel closer in their characteristics to private sector counterparts than government. In addition, many organizations of this type receive the majority of their funding from sources external to government, such as from donations from individuals and corporations and other NFPOs. Thus, they also see their accountability primarily to such donors or, in the case of indigenous government entities, to members rather than to government.

One Group member highlighted a need for PSAB to look at the reporting by indigenous governments, and that of their entities. One Group member noted that entities of this type may not feel the day to day presence of government in their activities – as long as those activities are consistent with government objectives. However, the presence of government is felt if their activities are inconsistent with government objectives and the government wants a change. Or if they experience a deficit, they may feel able to approach government to address it. They may also benefit from administrative services provided by government or its components or organizations or shared services with government or its components or organizations. The PSA Handbook states that a government may choose not to exercise its power; nevertheless, control exists by virtue of the government’s ability to do so.

The Group generally agreed with View A – there is a cascade of control. It was agreed that organizations controlled by Hospital A should apply the PSA Handbook for their own financial statements. Nevertheless, the Chair noted that PSAB’s research into the nature and needs of public sector NFPOs as well as PSAB’s development of a not-for-profit strategy may help the PSA Handbook to better meet the needs of this community in the future.

Introduction: Whether an Investment Holding Company Can Be a Government Business Enterprise

Investment holding companies are common in practice, particularly for municipalities and indigenous governments. There are significant implications for public sector reporting. Specifically, the designation of an investment holding company as an “other” government organization or a government business enterprise (GBE) would affect how the entity is included in government financial statements and the amount recognized in periodic financial statements in relation to the investment holding company’s results.

There is diversity in practice in respect of whether an investment holding company is designated as an “other” government organization or a GBE and, thus, whether the PSA Handbook or CPA Canada Handbook – Accounting standards, respectively, are applied in preparing an investment holding company’s financial statements.

It is common that governments hold investments in businesses through various holding company structures. Investment holding companies may hold interests in controlled investments that qualify as GBEs and may also hold other investments, such as portfolio investments or investments in government business partnerships.

There are a number of scenarios where the accounting differs depending on whether an investment holding company is considered to be a GBE itself and accounted for using the modified equity method or whether it is accounted for as a consolidated government organization.

For purposes of the discussion, an investment holding company is considered to be a separate legal entity that is set up to hold one or more investments in other legal entities. However, the structure, management and purpose of investment holding companies vary greatly. The purpose of the discussion is to consider the appropriate analysis framework to assist in distinguishing investment holding companies that are themselves GBEs from those that are not.

Issue 1 – When would an investment holding company be accounted for as a GBE?

This issue addressed whether an investment holding company itself needs to meet the definition of a GBE. Three views were considered. The submission noted that the question of whether an investment holding company can be considered a business is key to determining whether an investment holding company meets the characteristics to be accounted for as a GBE. This question is explored in Views A and B. In contrast, View C asserts that an investment holding company can be classified as a GBE if the majority of the investments it holds have the characteristics of GBEs.

View A – An investment holding company is a GBE because it meets all the characteristics of a GBE itself

View A asserts that an investment holding company can meet the definition of a GBE itself under certain circumstances when all the criteria in *Government Reporting Entity*, paragraph PS 1300.28, are met. If it meets the definition of a GBE, an investment holding company would be accounted for in the government financial statements using the modified equity method.

A GBE is by definition a government organization as required by paragraph .06 of the Introduction to Accounting Standards in the PSA Handbook. And a government organization is an organization controlled by government. So to be a GBE an investment holding company must be controlled by government. An investment holding company whose shares are 100 per cent owned by the government would likely be controlled by that government.

In addition, a government organization must also have all of the characteristics listed in paragraph PS 1300.28 to be a GBE.

View A reviews these characteristics and concludes that there are circumstances in which an investment holding company could meet the GBE definition. In particular, it argues that the description of a business in the characteristics as only relating to the sale of goods and services is too literal an interpretation and that such selling is only one example of business activities. View A asserts that the key criterion is the requirement for revenue to come from outside of the government reporting entity.

View B: An investment holding company cannot itself meet the characteristics of a GBE

View B asserts that an investment holding company would not itself meet the definition of a GBE primarily because it does not meet the definition of a business as required by the GBE characteristics. Thus, an investment holding company would be a government organization consolidated in the government's financial statements.

View B is distinct from View A in that it asserts that paragraphs PS 1300.28(b)-(d) may not be met for an investment holding company.

Even active management of investments would not meet the requirement that an investment holding company be operating a business. Active management of investments does not qualify as a business for the purposes of considering whether an entity meets the criterion in paragraph PS 1300.28(b). A strict reading of the guidance in Section PS 1300 would equate a business only with the sale of goods and services for the purposes of the GBE definition. This interpretation is consistent with the historical reasoning for the definition of financial assets and the inclusion of investments in GBEs as one type of financial asset.

In addition, when an investment holding company owns only investments in GBEs or other corporations within the government reporting entity, any dividends or other investment income received would not be from organizations outside of the government reporting entity. If GBEs are controlled by a government organization (the investment holding company) that is controlled by government, the GBEs form part of the government reporting entity (paragraph PS 1300.07). And there may not be an active market for some investments in GBEs or other government corporations. A government may create a business

because the activity is one that would not be profitable for a private sector organization and, thus, would not draw private sector investment. The ability to actively buy and sell investments in GBEs or other government corporations on an ongoing basis may be limited and, thus, affect the ability to characterize the investment holding company's activity as a business.

View C – An investment holding company is a GBE if a majority of its investments have the characteristics of GBEs

View C asserts a “bottom-up” approach in determining the classification of an investment holding company. View C asserts that if the (majority of) the investments held by an investment holding company are investments in GBEs, the investment holding company itself should be classified as a GBE. The investment holding company has no substantive operations other than those of the GBE(s) and, therefore, ultimately the characteristics of the investment holding company are the characteristics of its underlying investment(s). Thus, the investment holding company would be accounted for in the government financial statements using the modified equity method.

Views A and B evaluate the nature of the investment holding company and its activities and whether the investment holding company itself meets the GBE definition. In contrast, View C focuses on the nature of the investments held by the investment holding company. In particular, View C looks at whether the (majority of) the investments held by an investment holding company are investments in entities with the characteristics of GBEs. Under View C, whether the investment holding company itself is considered a business or not is irrelevant to determining if it is a GBE. Whether the investment holding company actively manages or passively holds investments is also irrelevant to determining if it is a GBE.

The Group's Discussion

A couple of Group members indicated that View B reflects a too literal, and perhaps more “form over substance”, interpretation of the characteristics of a GBE as set out in Section PS 1300. Discomfort was expressed over the possibility that stretching the GBE definition to include an investment holding company may facilitate a particular accounting result not intended by the standards. However, it was noted that it should be theoretically possible for an entity established to hold but also actively manage a portfolio of investments in entities outside of the government reporting to constitute a business for the purposes of the GBE definition.

Another Group member commented on the private sector use of an investment holding company, which is normally established just to hold an investment or investments, for business, legal or tax purposes. The strategic objective of establishing an investment holding company structure within government should be considered in determining the substance of the entity and the nature of its activities.

One Group member noted that the differing operating statement effect of the classification of an investment holding company as a GBE or an “other” government organization is the real issue, as reflected in the examples considered by the Group:

- If an investment holding company sells part of an investment in a GBE and the investment holding company is an “other” government organization (View B), it would apply the PSA Handbook and would proportionately consolidate the remaining investment in the investment holding company.

The gain or loss on sale would ultimately be reflected in the annual results of the government in the period of sale.

- Alternatively, under the same scenario, if the investment holding company is considered to be a GBE (View A or C), it would apply IFRSs. The sale would not lead to a loss of control of the GBE by the investment holding company, so it would still be fully consolidated by the investment holding company. The investment holding company would not recognize any gain or loss in its income statement because under IFRS 10, *Consolidated Financial Statements*, transactions that do not give rise to a loss of control are accounted for in equity. So there would be no impact on the annual results of government in the period of sale.

The Group did not support View C. However, its merits were discussed with some Group members appreciating the “look-through” approach to the investments and others adhering to the need for the investment holding company itself to meet the GBE definition. Some were concerned that endorsing a look-through approach to the investments of the investment holding company in determining the nature of the entity would have implications for other government organizations and could affect the GAAP they use for their financial statements. To illustrate the concern with an extreme example, one Group member noted that if a critical mass of the organizations of a government were GBEs, then the government itself would then be considered a GBE and would use IFRSs in preparing its financial statements.

A further concern raised was that under View A, an investment holding company would have to be operating as an active investment business in order to be a GBE, while under the bottom-up approach suggested in View C, it would be possible for an investment holding company to be a GBE even if it only passively held one investment in a GBE. This seemed contrary to the intended “operating a business” nature of GBEs and the reasons they were identified for modified equity accounting by PSAB and required to use accounting standards for publicly accountable enterprises. It was also noted that the investment holding company’s investments in GBEs would have to be actively traded and managed by the investment holding company and would need to be investments in entities outside of the government reporting entity. Otherwise, the investment holding company would not be receiving its investment income from sources external to the government reporting entity and, therefore, could not qualify as a GBE.

One Group member reiterated the passive characteristics of a traditional investment holding company as set out in the submission. By definition, holding companies are not active businesses and, thus, View A would not be possible. The submission noted that holding companies often have no economic substance. It makes no difference to the economic position of the government whether they exist or not. They are often put in place for legal protection purposes (corporate veil) or for convenience (as a way to permit non-controlling interests to co-invest in the underlying investments) or because of historical reasons relating to previous restructurings. Holding companies are not generally “enterprises” in the dictionary sense of that word, which envisions bold or difficult undertakings or a functioning business. In most cases, an investment holding company by definition would normally only passively hold investments, and the investments would normally be intended for the long-term receipt of dividends and capital gains.

Ultimately, there was little support for View C. But there was otherwise not a firm consensus from the Group. There was some acknowledgment that most investment holding companies would not be GBEs. However, some Group members felt that theoretically an investment holding company with an active investment services “business” could qualify as a GBE but that its purpose would have to be to generate revenue from sources external to the government. In contrast, a simple investment holding company set up to hold passively a single investment in a GBE would merely be an extension of the government parent and the investment holding company would not apply a GAAP different from its parent.

Issue 2 – Does an entity need to be controlled by government to have the characteristics of a GBE?

This issue was deemed relevant to consider only if View C in Issue 1 was considered a viable approach to evaluating the nature of an investment holding company. Under the bottom-up approach set out under View C of Issue 1, the nature of the investments held by the investment holding company would determine the nature of the investment holding company. Thus, the possible population of investments for an investment holding company that would qualify it to be a GBE is bigger if an entity does not need to be controlled by government to be a GBE.

Two views were considered.

View A – A GBE is a government organization so, by definition, each investment held by the investment holding company must also be controlled by government to have the characteristics of a GBE

As defined in the Introduction, a GBE is a government organization. And a government organization is an organization controlled by government. So, under View C of issue 1, to be a GBE an investment holding company must hold investments that are controlled by government.

Paragraph PS 1300.28 does not use the term “government” in front of “organization”. However, paragraphs PS 1300.32-.33 clearly mention that a government business enterprise is a government organization.

View B – Paragraph PS 1300.28 does not include control by government as a necessary characteristic of the definition of a GBE

View B asserts that paragraph PS 1300.28 does not require an entity to be a controlled entity in order to qualify as a GBE. The defined term “government organization” is not used in paragraph PS 1300.28 – it merely requires a GBE to be an organization with certain specific characteristics. Thus, an entity would only be required to meet all of the characteristics listed in paragraph PS 1300.28 in order to have all the characteristics of a GBE (see the evaluation of these under View C, Issue 1 above). The Introduction is not GAAP. So only the requirements in paragraph PS 1300.28 would need to be considered in determining if a public sector entity is a GBE.

The Group’s Discussion

Although the consensus in Issue 1 was that View C was not appropriate, the nature of the question in Issue 2 raised a concern. The Group agreed that it is self-evident that a GBE has to be controlled by government. A government organization is by definition controlled by government. And a GBE is by

definition a government organization. One Group member noted the PSAB's Terminology project, when it is restarted, could clarify paragraph PS 1300.28 to remove the possibility that a literal interpretation could conclude that a GBE does not have to be a government organization.

Sections PS 1000, PS 1201: Recognition Prohibitions and Urban Forests

An urban forest is a forest or a collection of trees that grow within a city, town or a suburb. It includes street trees, residential trees, park trees and greenbelt and ravine plant and animal communities, and provides habitat for a diversity of urban wildlife.

The submission raised the issue of accounting for urban forests as assets, as well as some related questions about what is the asset, if it should be depreciated, what measurement attribute should be used, etc. The submission was characterized as raising a “natural capital” issue and whether natural capital should be recognized in financial statements. Urban forests were suggested as a first issue (the “thin edge of the wedge”) because local governments have the information on these natural resources. They count their “street trees” and many have also put a value on them using valuation techniques that are being used internationally and are well thought of. Some local governments are including green infrastructure in their asset management plans.

Arguably, urban forests are a type of natural resource. Existing standards would allow only purchased natural resources to be recognized in public sector financial statements if they meet the asset definition in *Financial Statement Concepts*, paragraph PS 1000.35, related guidance in paragraphs PS 1000.36-.37 and Section PS 3210, *Assets*, as well as the general recognition criteria in paragraphs PS 1000.52-.59. The recognition prohibitions in paragraph PS 1000.57, and *Financial Statement Presentation*, paragraphs PS 1201.068-.069, reflect a presumption that inherited natural resources cannot be measured. The submission argued that this presumption is dated and can be rebutted given advances in measurement techniques for natural capital.

Local governments across Canada are faced with significant infrastructure challenges. A changing climate will only intensify these challenges.³ Natural capital provides important services, in some cases, as a cost-effective alternative to “built” or “grey” infrastructure.⁴

With municipalities, limited in their budgets and revenue options, these natural assets may provide significant unrecognized value. Municipalities arguably need to manage their natural assets with as much accounting rigour as their purchased or constructed assets.

The submission argued that there is a window of opportunity when municipalities are developing their asset management systems to build in the potential for tracking and managing natural assets too. Permitting the inclusion of natural capital in financial statements would send the signal that natural assets are worth managing. This could lead to improved overall stewardship of infrastructure in Canada.

³ [Low Carbon Resilience: Transformative Climate Change Planning for Canada](#), 2016 Adaptation to Climate Change Team, School of Public Policy at Simon Fraser University

⁴ [Incenting the Nature of Cities: Using Financial Approaches to Support Green Infrastructure in Ontario](#), 2016, The George Cedric Metcalf Charitable Foundation

Urban forests are one important type of natural capital. Despite their enormous value to society, urban forest canopies are stressed and in decline in many parts of the country. Hot, dry summers and increasingly frequent and extreme storms are wreaking havoc on city trees. Urban development, invasive species like the emerald ash borer beetle and other threats have also reduced growing space and killed millions of trees.

“Urban forests have a substantial monetary benefit to the municipalities, provincial and federal governments (storm water attenuation, air quality mitigation, tourism, health care costs, sequestering of gaseous air pollutants and particulates, energy conservation, etc.), to residents (noise buffering, property value, energy conservation, etc.) and business (tree care companies, nursery industry, aesthetics of retail areas). Internationally, many cities are recognizing that their urban forests will play an important role in their competitiveness to attract business and industry.

The benefits accrue not only to the owners of the trees and forest but also to the entire community. While the same can be said for the wildland forests of Canada, the connection in the urban forest is much more obvious and dramatic because the beneficiaries live within it. A recent trend has been to evaluate trees, shrubs and greenspace by applying economic models to what is increasingly known as "green infrastructure".⁵

Trees planted as part of the cost of another asset, such as landscaping for a building or trees planted as part of a highway development, would already be capitalized by virtue of being included in the cost of the related asset. Section PS 3150, *Tangible Capital Assets*, allows such capitalization.

The reporting model in the PSA Handbook is primarily an historical cost model. Accounting for urban forests based on their historical cost may not provide the information necessary for sustainability reporting related to such resources. In particular, it is unlikely that the historical cost of a tree reflects its carbon capture or water management or other such benefits. And it would not reflect the appreciation in the value of the tree as it matures. The benefits provided by a tree increase as its size increases.

Scenario

- An urban forest exists within a municipality.
- The urban forest consists of trees in municipal planters and gardens, street and highway trees, residential trees, park trees, greenbelt and ravine trees, and the interspersed woodlots of a more rural landscape at the fringes of the municipality. Thus, the urban forest comprises trees that are on municipal property and also those on the property of others within the municipal borders.
- Some trees are already capitalized as part of other municipal assets at their historical cost.

The Group's Discussion

These issues were considered by the Group:

1. Do urban forests meet the definition of an asset?
2. If urban forests meet the definition of an asset, what is the asset?

⁵ <https://treecanada.ca/en/programs/urban-forests/benefits/>

3. Is amortization of the asset appropriate or possible?
4. If urban forests meet the definition of an asset, how should they be measured?
5. If an urban forest is an asset and is measurable, and an entity includes it in its financial statements, should an auditor qualify the financial statements while the recognition prohibitions are still in place?

Most of the discussion focused on Issue 1.

Group members sought and received clarification on various matters before commencing their discussion:

- One Group member raised the issue of wilderness forests, the Gibsons BC aquifer example referenced in the submission and other natural resources, indicating the implications of including urban forests in financial statements for other natural resources. It was acknowledged that the urban forest issue is a “wedge issue” in that it has implications for including other natural resource items. It was submitted to the Group for consideration because valuation techniques for, and inventories of, street trees now exist (thus, rebutting the inability to measure presumption in existing standards). At a minimum there are inventories of species, size, location and condition of urban forests in many municipalities. Reflecting the value of the eco-services provided by such forests would be more difficult and precedential for financial statements.
- Another Group member noted that the implications of including natural resources like urban forests on the statement of financial position would have as a by-product a reduction of pressure on the annual results statement. This by-product was acknowledged as a possibility. However, it was clarified that it was not the intent behind the submission. The capitalization of urban forests as assets in the financial statements would remove acquisition expenses from results. However, the intent behind the capitalization would be to seek budget allocations for better and more consistent replacement and maintenance of the forest in order to ensure that municipalities continue to benefit from the eco-services provided by the forest and assist them in mitigating the impact of climate change on their jurisdiction.
- A question was raised about whether a liability should be recognized for maintaining the canopy of the forest. It was clarified that a first step is to consider the merits of asset accounting for urban forests. Further, as liabilities for future (or deferred) maintenance of tangible capital assets are not now recognized as liabilities in financial statements, it is unlikely that a precedent would be set by requiring such recognition in relation to urban forests.
- One Group member also raised a question about the impact of invasive species and whether replacement trees of different species would be considered when recognizing the asset. It was noted that asset impairment questions would arise if urban forests are recognized as assets. The question of how replacement trees would be accounted for would depend on whether the asset accounted for is an individual tree or the forest as a whole. PSAB would need to consider all aspects of asset accounting in establishing standards for urban forests if they are considered to meet the asset definition.

Issue 1 – Do urban forests meet the definition of an asset?

Three views were considered.

View A – Urban forests meet the definition of an asset and should be reported in financial statements

This view states that urban forests represent an asset of the municipality in which a forest resides. It argues that each aspect of the asset definition is met.

- Economic resource: Urban forests are tangible; they comprise natural resources; they are a form of natural capital. Forests are economic resources because they comprise scarce commodities (i.e., trees and other natural aspects of the forest that can be used actively for consumption, production, exchange or passively for providing economically quantifiable benefits to a jurisdiction and its population, such as carbon capture, storm water management, etc.). Trees and other natural aspects of urban forests are increasingly scarce as a result of global depletion of natural capital.
- Control: The parts of the urban forest that are on municipal property are clearly owned by the municipality. They are also controlled by virtue of that ownership even if their management or use is restricted or affected by provincial or federal legislation. The parts of the urban forest that are not on municipal property are controlled through regulation and by-laws such as those requiring notification of private tree removal, maintenance of private trees, pruning of trees that affect municipal infrastructure or public safety, and replacement of removed private trees. The municipality can deny or regulate access to the benefits of an urban forest by others through regulation, by-laws, and physical barriers – on municipal property and on private property (for example, when there is construction that might damage a tree, when there are considered to be dangers in a park, in order to charge fees for use of a park or conservation area, when a tree is considered unhealthy and might damage municipal infrastructure, etc.).
- Resulting from a past event: The past events giving rise to an urban forest include: the purchase, donation, inheritance or biological/ecological growth (as from a seed due to natural propagation) of the trees that comprise the forest.
- Future economic benefits expected to be obtained: The tree and other natural aspects of an urban forest provide future economic benefits in the form of goods and services and reductions of future cash flows. The municipality will receive many of these benefits by virtue of the existence of the urban forest, regardless of the location of trees on municipal or private property. The population of the municipality will also share in these benefits. Municipalities that have an urban forest are better off than municipalities that don't. A municipality that has such green infrastructure may as a result spend less on grey (i.e., built) infrastructure. An urban forest helps a municipality achieve its objective of providing public goods and services to its constituents, so a municipality derives benefits from an urban forest.

View B – Urban forests do not meet the definition of an asset

Urban forests are economic resources and arise from past events. But this view asserts that an urban forest does not otherwise meet the definition of an asset because the whole forest is not controlled by the government and the allocation of the benefits of the forest between the government and the

population cannot be determined. It is also possible that the costs associated with managing and maintaining the forest may outweigh the benefits.

- **Control:** Only a portion of the trees in an urban forest are controlled by the municipality. Trees on municipal property would be an economic resource of the government. Trees that reside on the property of others would not be economic resources of the municipality; they are not owned or controlled or maintained by the municipality. Municipal regulation and by-laws related to the management of trees on private property does not constitute control. Regulatory power does not constitute control because the regulatory body's interest extends only to the regulatory use of the economic resources and does not include the ability to control access to the future economic benefits. The ability to erect temporary physical barriers for justifiable public safety reasons does not constitute control.
- **Allocation of Benefits:** The nature and extent of the benefits associated with the forest that are realized by the municipality as opposed to its population may be difficult to ascertain. Many of the cited economic benefits provided by trees may be quantifiable using existing methods. However, the attribution of those benefits to a government versus its population may be difficult to reliably allocate for financial statement purposes. In addition, the calculation of future costs saved (i.e., realized) because of the benefits provided by an urban forest may be problematic.
- **Costs of the Forest:** Investing in a tree's maintenance will help to retain its benefits but the maintenance of trees also gives rise to costs. And there may be asset retirement obligations associated with them that outweigh any benefits represented by the historical cost of the trees in the forest. The costs associated with large tree removal and replacement can be significant and may comprise an asset retirement obligation for the municipality. Such obligations assume that a municipality would wish to maintain or enhance its tree canopy, which may not always be a valid assumption. The condition, species and age mix of an urban forest may also impact the nature and extent of the benefits related to the forest at any point in time. The economic and environmental benefits produced by a young replacement tree are minimal when compared to those of a mature specimen. Extending the functional lifespan of large, mature trees with routine maintenance can delay these expenses and maximize the benefits. However, the extent of deferred maintenance related to a forest may be an issue when trying to determine the nature and extent of the benefits to be realized from an urban forest.

View C – Urban forests represent economic resources but reporting on them is best suited to reports outside of financial statements

A municipality and its population benefit from the entire urban forest within its boundaries, not just that portion of the forest that is on municipal property. Traditional financial statements would only accommodate accounting for the part of the forest that is an economic resource of the municipality because financial statements report only the financial position and results of the reporting entity, not that of the jurisdiction as a whole.

In addition, the historical cost of the portion of the forest that is on municipal property, if it can be estimated, in no way represents the benefits of an urban forest. The management, sustainability and

maintenance of natural capital is important for the future of the planet; including urban forests in traditional financial statements will not provide enough information to support such objectives.

More holistic stewardship reporting that includes both financial and non-financial information such as the condition, annual depletion and sustainability of an urban forest as well as some representation of the value of the benefits provided by urban forests would be more useful. Such stewardship reporting could be provided separate from or accompanying traditional financial statements.

The Group's Discussion

The Group accepted that urban forests represent natural resources and are economic resources as required by the asset definition and that past events have given rise to such resources. The primary issues under debate were whether all or part of the forest is controlled by the government, the attribution of benefits from the forest to the government, the costs related to maintaining the forest canopy and keeping the forest safe and managed, the valuation of forests (see Issue 4) and the possible stewardship reporting of urban forests.

The discussion addressed wilderness trees as well and, thus, introduced questions that would be more problematic in terms of asset identification and valuation. The submission had focused on urban forests as an initial step given the greater experience with such forests, the fact that many have already been inventoried, and experimentation with good valuation models has been occurring for some time.

One Group member indicated that those trees on municipal property would be controlled by the municipality and conversely trees residing on private properties would not be controlled by the municipality, which was more in line with View B. Another Group member reflected on the experience of the BC government with respect to First Nations negotiations in relation to control of land – forests on land for which Crown control is in dispute could not be included in the government's assets. In other jurisdictions the control over assets such as these would also be an issue for First Nations as the land on which the trees live are considered federal lands but the First Nations get the benefits from the forests on the land. An attribution of benefits question arises that might affect whether a First Nation can recognize a forest as an asset and the measurement of the forest asset for a First Nation.

One Group member highlighted the costs, as contrasted with the benefits, of having an urban forest, including that trees block light to homes and gardens, their roots can damage grey infrastructure, they may cause property damage in storms, may have health care implications for humans, etc. The intent of the comment was to balance the emphasis in the submission with respect to the benefits of trees. These potential costs were acknowledged. However, it was noted that having an inventory for, and value of, the forest would allow for its proactive management and mitigation of some costs of the forest, in particular any potential negative impacts on grey infrastructure.

One Group member reflected on the nature of trees as public goods, indicating that the benefits they provide are non-exclusionary in that no one can appropriate them. As public goods, they should arguably be reported by government. There are also potential liabilities associated with forests; they need to be maintained and such maintenance may be costly. And the member also questioned if a government commits to stewardship over forests, does it also commit to their maintenance and do such commitments then impose a fiscal sustainability risk on governments? Another member agreed noting

that having urban forests is a form of public service and, thus, is similar to many other assets owned by the municipality with more indirect benefits.

In considering View C, it was noted that current standards limit what can be reported within financial statements for urban forests. Reports outside financial statements would provide flexibility beyond that currently allowed and would be a good first step. One Group member characterized the Group's discussion as the start of a conversation. Similar to the evolution of tangible capital asset accounting and management, accounting for, and management of, natural capital will likely evolve over time. Standard setting takes time. And society needs to evolve in its thinking about the role and value of natural capital and may in the future consider the use of green infrastructure in place of grey when doing so is viable. If governments put a price on carbon, then society may recognize the value of those things that absorb carbon.

The Group generally felt that forests provide value to jurisdictions and that they would probably meet the asset test but that measurability is an issue and the verifiability of such measurements may be problematic.

Issue 2 – If urban forests meet the definition of an asset, what is the asset?

Two views were considered.

View A – Individual trees are the assets

For financial statement purposes, the trees represent the most identifiable economic resources. Recognizing entire ecosystems that exist within the boundaries of a municipality as assets in the financial statements of that government may not lend itself to verifiable measurement of sufficient credibility to be included in financial statements.

View B – The urban forest as a whole is the asset

Either the individual trees or the forest as a whole could be the asset. But treating individual trees as individual assets is not cost effective and would not add sufficient value in relation to the effective management of an urban forest to justify the cost of managing such detail. The determination is not theoretical but practical. Separation of the forest into the parts that are municipally owned and those that are privately owned would likely be required as only that portion of the forest on municipal property would be an asset of the municipality.

The Group's Discussion

One Group member noted that if the purpose of reporting on a forest is stewardship, rather than income, the forest as a whole should be accounted for – not the individual trees.

Another Group member reflected on the interconnectedness of the forest and the related ecosystems, and indicated that it was important for the forest to be accounted for as a whole rather than by individual tree.

The Group noted a practical concern over the need to inventory all trees and concluded that if a forest was accounted for as an asset, then the forest as whole would be the asset – not the individual trees. This concern was an issue more with wilderness than street trees.

Issue 3 – Is amortization of the asset appropriate or possible?

Two views were considered.

View A – The assets are the individual trees; they should not be amortized; they are assets until or as they die

The benefits associated with the lifespan of a tree, regardless of species, start small and increase with age and size, reaching a kind of plateau for a large mature tree. The extent of the plateau varies by species. The lifespan and the benefits of trees are also affected by weather, in that extreme weather such as storms or drought can damage or kill trees, and by infestation and by human action (or inaction if maintenance is not carried out). Eventually a tree deteriorates and dies and the benefits associated with it are reduced and then lost.

View B – The whole forest is the asset; periodic changes in the number and value of the trees in the forest should be reflected in periodic results accounted for on a component basis

Like a water or sewer system, an urban forest is a kind of network asset – a system that is made up of components that are, at a minimum, the individual trees. Therefore, maintenance and repairs to existing trees would be considered to maintain the service potential of the forest and would be charged in the accounting period in which they are made. In contrast, betterments, such as an increase in the tree canopy would increase the service potential of the forest and such expenditures would be included in the cost of the urban forest asset. Significant decreases in the tree canopy because of tree age, weather, infestation, or other natural disasters that kill or irrevocably damage trees would be treated as disposals as they occur and reflected in expenses.

The Group's Discussion

Consistent with the conclusion that it was probably more appropriate to look at the forest as a whole as the asset, the Group felt that amortization would not be appropriate. Instead, the changes in value of the forest would be recognized, including impairment and appreciation. Nevertheless, the Group agreed that it was premature to speculate on detailed accounting treatments and reaffirmed that stewardship reporting should probably be a first step. Stewardship reporting would not require consideration of the impact of changes in value on annual results.

Issue 4 – If urban forests meet the definition of an asset, how should they be measured?

Three views were considered.

View A – Only purchased trees in an urban forest should be recognized in financial statements and they should be recognized at their historical cost; inherited trees should not be recognized

This view is consistent with the measurement attribute mandated in the PSA Handbook – historical cost – and takes into account the recognition prohibitions in existing Sections PS 1000 and PS 1201. Currently, inherited natural resources are prohibited from recognition in public sector financial statements on the presumption that they cannot be adequately measured using existing measurement techniques.

View B – Purchased trees in an urban forest should be recognized in financial statements at their historical cost; inherited trees should be recognized and measured at their estimated (a proxy for) historical cost

This view would argue that all municipal trees in an urban forest should be recognized in the financial statements. Existing measurement techniques can be used to estimate the historical cost of inherited trees.

View C – An urban forest should be recognized in financial statements at a value that considers the nature and extent of all the benefits provided by the forest to the government

This view argues that the historical cost of trees does not adequately reflect the future economic benefits associated with an urban forest. New measurement techniques for various types of natural capital exist that better reflect the economic benefits that they provide to a government and its population.

The Group's Discussion

Valuation questions raised included how location, species, size, condition and purpose of the tree would be considered in compiling a hard number for the value of a forest for financial statement purposes – even for an historical cost proxy, much less for a valuation that would take into account the value of the benefits that trees can provide. It was acknowledged that these questions would pose more of an issue for wilderness forests. Factors such as stumpage fees, silviculture and liabilities for replanting would also pose valuation issues in jurisdictions where there is a forestry industry, especially if there are government subsidies for the cost of trees. For urban forests, a designated boundary would have to be established in order to value and manage the forest. The verifiability of the measurement of an urban forest was also raised as an issue.

One Group member indicated that the value of an asset that is a public good should reflect the purpose for which it is held, the capacity the asset has to meet that need and changes in that capacity. Another noted that a survey and appraisal by experts may be needed to establish an initial historical cost of a forest or to establish a current value that takes into account a number of difficult-to-measure benefits of a forest. Such an appraisal could be improved over time as measurement techniques evolve but getting a preliminary measurement would be a foot in the door in terms of providing information to the public. The measurement method would have to be able to be verifiable and withstand professional scrutiny.

The Group agreed that the historical cost of the forest would be less useful than some current value of the benefits of the forest. Trees appreciate in their value and in the benefits they provide as they grow and historical cost would not reflect such appreciation or benefits. Nevertheless, getting an initial historical cost measure of a forest may be a good reliable start. There was a consensus that experimentation with reporting on the nature, extent and value of an urban forest in reports outside of financial statements would be a good first step. Information about the sustainability of the forest and how it is being managed, as well as its carbon capture and other benefits, would also be useful.

Issue 5 – If an urban forest is an asset and is measurable, and an entity includes it in its financial statements, should an auditor qualify the financial statements while the recognition prohibitions are still in place?

Two views were proposed for consideration, but were not specifically addressed by the Group.

View A – An auditor should qualify the opinion on the financial statements

Existing GAAP in paragraphs PS 1201.068-.069 does not allow the recognition of inherited natural resources in public sector financial statements. Financial statements that include them as assets do not comply with GAAP, and if such assets are material, an auditor should consider a qualified opinion.

View B – An auditor should not qualify the opinion on the financial statements

The recognition prohibitions in existing GAAP in paragraphs PS 1201.068-.069 reference the same prohibitions in conceptual framework paragraph PS 1000.57-.58. The reasons stated for non-recognition of inherited natural resources and other items such as intangibles, is that they “are not recognized as assets because the costs, benefits and economic value of such items cannot be reasonably and verifiably quantified using existing methods.”

If an auditor agrees that:

- an urban forest meets the definition of an asset for a municipality (in whole or in part);
- the measurement of the asset is at historical cost;
- the measurement techniques and resulting value are considered appropriate;
- the accountability value of the financial statements is increased by including the asset; and
- to not include the asset would be misleading;

then the auditor should consider not qualifying the opinion on the financial statements.

The Group’s Discussion

The Group agreed that commenting on what an auditor might or might not do is not appropriate for the Group. Members felt that planning to include new items in the financial statements should be a topic brought up with the auditor on a proactive and co-operative basis as a general practice.

Instead, the discussion addressed if the presumption that the prohibited items could not be measured is rebuttable. Some Group members felt that the prohibitions are in place and should be followed until PSAB addresses the issues. Others felt that the public would expect resources to be included in financial statements if they meet the asset test and can be verifiably measured. A question was raised as to whether a qualified opinion would be in the public interest in such circumstances.

Sections PS 1000, PS 1201: Recognition Prohibitions and Early Intervention Investments

The submission asserted that it is in the public interest for PSAB to issue an accounting standard for intangibles that would allow for the capitalization and amortization of health and social investments, in particular early intervention investments by public sector entities in Canada. It noted that capitalization

of early intervention investments would encourage such investments and recognize the long-term benefits associated with them. And it argued that allowing for the capitalization and amortization of early intervention investments would have positive public policy implications to assist the public sector in addressing significant and growing social challenges. Thus, intervention could be encouraged to be proactive rather than reactive.

This issue was characterized as relating to human capital and whether it should be recognized in financial statements.

The submission raised issues relating to the appropriateness of the same recognition prohibition paragraphs in *Financial Statement Concepts*, Section PS 1000, and *Financial Statement Presentation*, Section PS 1201, discussed in relation to [urban forests](#) at this meeting, which considered whether urban forests meet the definition of an asset.

The proposal focused on qualifying early intervention investments as evidence-based measures to improve the well-being of individuals and families. A definition was proposed for early intervention investments for use in the discussion:

An early intervention investment is an investment arising from expenditures in the social sphere by a public sector entity to address a social issue for which early intervention is expected to reduce future outlays of the entity (such as education, social services or health costs) and provide future benefits to the entity (such as new income tax revenue from the recipient population assisted by the investment), while simultaneously providing social and/or clinical benefits to an identified recipient population.

The following issues were considered:

1. Are early intervention investments intangible assets for financial statement purposes? Do they meet the criteria to be reported as an asset in financial statements (Section PS 3210, *Assets*)? Or is reporting on such investments more suited to reporting that is outside financial statements, such as stewardship reporting?
2. If early intervention investments are assets, is amortization of such assets appropriate?
3. If early intervention investments are assets, how should the assets be measured – at historical cost or at some other value that reflects the benefits of an early intervention investment?
4. If an early intervention investment is an asset and is measurable, and a public sector entity includes it in its financial statements, should an auditor qualify the opinion on the financial statements if the recognition prohibitions are still in place? Or would such a qualification not be appropriate because it is in the public interest for the early intervention investment to be reported for accountability purposes?
5. Can early intervention investments be sufficiently distinguished from other government spending? Are there risks to PSAB and to the accountability provided by public sector financial statements if a precedent is set by permitting early intervention investments to be recognized as assets rather than in expenses when incurred?

There may also be subsequent measurement issues such as impairments, betterments and changes in amortization to consider. These were not addressed in the submission as its goal was to first consider whether early intervention investments are assets for financial statement purposes.

Scenario

- An early intervention investment, as defined above, is made by a government.
- The investment relates to autism services to an identified population for specific services over specific periods of time. In this case, the services are to be delivered to the individuals in the specified population from ages two to five years old. Intake age for individuals into the program is two years. The investment is made when the individuals in the population to be served are all two years old.
- The investment is one-time for that population and is clearly intended to finance the delivery of specific services to that specific population over the specified time periods.
- Additions to the investment can only comprise spending to maintain the specified level and type of services to the defined population over the specified time periods.
- Spending relating to other populations (for example, a new intake population to be served) or to finance services or costs for the identified population that were not specifically identified and financed up front would not be added to the investment.
- The benefits to the government relating to the investment are considered to arise subsequent to the delivery of the services in the form of cost savings, and perhaps increased tax revenue when the served population reaches working age.
- The early intervention investment has the following additional characteristics:
 - There is evidence that early intervention spending of this type has been effective in delivering similar benefits for some portion of a sufficiently large cohort of subjects in different milieu and at different times. Thus the early intervention investment is directed towards a suitably sized cohort such that it will generate the outcomes and the savings that research has demonstrated are achievable. For example:
 - Externally validated high-quality research supports the contention that early intervention with the identified population improves the functionality of the served individuals.
 - Externally validated high-quality research indicates that the future cost savings are realizable and exceed the cost of early intervention; the benefits to the investing government are predictable and quantifiable.
 - Validity of the evidence was considered and found appropriate. Consideration of the internal validity of the evidence included evaluation of the quality of the evidence regarding the context, effectiveness and anticipated net benefit of the intervention. Consideration of the external validity of the evidence included evaluation of whether there was confidence that high-quality evidence of the effectiveness and net benefit of an intervention tested in

one setting would indicate that implementation of the intervention in other settings would generate similar results.

- The program is one that government would find difficult to eliminate because the demonstrable need is and is expected to continue to be significant over a predictable, justifiable and quantifiable future period.
- The identified population to be served by an individual early intervention investment is expected to remain stable and identifiable and associated with the program. Reductions in the population over the periods of service delivery, as well as over the anticipated benefit period, can be estimated and considered for accounting purposes. No additions to the identified population would occur once the early intervention investment has been made as each such investment is identified with a defined population at intake into the program.

Issue 1 – Do early intervention investments meet the definition of an asset?

Group members sought and received clarification on various matters before commencing their discussion:

- One Group member requested clarity regarding the extent of the costs to be capitalized as an early intervention investment asset. The question was whether the cost would relate to the delivery of the program only or if it would include up front planning and research costs too. The intent was to understand how far back costs incurred in relation to the program would be considered for capitalization. In response, it was noted that the intent would be to focus primarily on the costs of direct delivery of the program to beneficiaries for establishing the early intervention investment. The research conducted before service delivery would likely comprise intellectual property of the entity and not form part of the early intervention investment.
- Clarity was requested regarding the period over which an early intervention investment would be recognized in expenses when amortized. The submitters clarified that each early intervention investment would be associated with the costs of the program for a specific cohort identified to receive benefits over an established period. For example, for an autism program, the expense recognition period would likely be three years as the beneficiaries are served from age two to five. In general, the schedule of the benefits delivery and their intensity would determine the amortization schedule.
- One Group member asked about the consistency of the business case for such investments between jurisdictions. The submitters indicated that a common methodology would have to be agreed upon, perhaps for each type of service, which should be generalizable to multiple jurisdictions. In addition, the evidence supporting the treatment of an early intervention investment as an asset would need to have internal validity.⁶ The intent would be to ensure that decisions on spending allocations for social programs would be evidence based.

⁶ Web Center for Social Research Methods, Research Methods Knowledge Base: Internal Validity is only relevant in studies that try to establish a causal relationship. It's not relevant in most observational or descriptive studies, for instance. For studies that assess the effects of social programs or interventions, internal validity is perhaps the primary consideration. In those contexts, you would like to be able to conclude that your program or treatment made a difference -- it improved test scores or reduced

- One Group member questioned whether a motive of the proposal is to impact annual results, given that early intervention investments would be treated as assets rather than expenses. The initial impact on results was acknowledged; however, it was noted that the investments would be amortized, sometimes over short periods depending on the program, which could mitigate the impact on results. Nevertheless it was stated that the motivation behind the proposal for early intervention investments to be accounted for as intangible assets is to encourage more early intervention investments for social policy reasons rather than to impact the calculation of annual results.
- A presentation solution on the operating statement was proposed by one Group member as an alternative to asset treatment for early intervention investments. Spending on early intervention investments could be reported separately from other spending in order to distinguish its nature. While this approach was acknowledged as a possibility, it was noted that the proposed asset treatment was intended to reflect the assertion that early interventions provide quantifiable and realizable future benefits to government, similar to other investments.

Four views were considered.

View A – Early intervention investments meet the definition of an intangible asset

Early intervention investments are intangible in nature in that they lack physical substance and cannot be touched. The PSA Handbook does not currently allow intangibles to be recognized in public sector financial statements on the presumption that they cannot be measured. Nevertheless, it may be argued that some intangibles meet the definition of an asset and can be measured, so they could be recognized.

The PSA Handbook does not currently include a definition of intangible assets. IAS 38, *Intangible Assets*, provides a benchmark as to the nature of intangible assets and can be used to evaluate whether early intervention investments meet the definition of an intangible asset as currently defined. IPSAS 31, *Intangible Assets*, may provide public-sector-specific considerations relevant to the evaluation.

IAS 38 and IPSAS 31 define an intangible asset as: “An intangible asset is an identifiable non-monetary asset without physical substance.”

Intangible in nature: An early intervention investment is an identifiable upfront financing arrangement for a defined and proven early intervention program for which research provides definitive evidence of future cost savings to the investor.

Among other things, IAS 38 and IPSAS 31 apply to expenditures on advertising, training, start-up, and research and development activities. Those standards make the distinction that research and development activities are directed to the development of knowledge. Therefore, although these

symptomology. But there may be lots of reasons, other than the program, why test scores may improve or symptoms may reduce. The key question in internal validity is whether observed changes can be attributed to a particular program or intervention (i.e., the cause) and **not** to other possible causes (sometimes described as "alternative explanations" for the outcome). <http://www.socialresearchmethods.net/kb/intval.php>

activities may result in an asset with physical substance (for example, a prototype) the physical element of the asset is considered secondary to its intangible component (i.e., the knowledge embodied in it).

An early intervention investment represents an investment in the development of abilities and knowledge (functionality) in the specified served population. The spending on early intervention is in the nature of an investment in that it is expected to provide returns, both to the spending government and to the served population – returns that are not just social but also financial in nature in the form of cost savings and future tax revenue.

Economic resource: Early intervention investments are economic resources because they provide economically quantifiable benefits to a jurisdiction and the population served by such early intervention programs. They enable the investor government to meet its policy objectives in an efficient and effective manner. Not all intervention programs would comprise an economic resource.

Only those early intervention programs:

- for which externally validated high-quality research evidence exists that spending of this type has been effective in delivering similar benefits for some portion of a sufficiently large cohort of subjects in different milieu and at different times; and
- are directed towards a suitably sized cohort such that it will generate the outcomes and the savings that research has demonstrated are achievable;

would qualify as early intervention investments and comprise an economic resource.

Control: A government would control an early intervention investment through clearly defining the evidence required to support the program, the boundaries of the program, who it will serve and how it will serve them as well as establishing accountability responsibilities to the government. Monitoring of the program, its progress and outcomes would also play a role.

Past transaction or event: The past transaction that gives rise to the economic resource is the investment in a qualifying evidence-based, early intervention program.

Future economic benefits: The proposal that qualifying early intervention investments be considered amortizable intangible assets flows from the results of published worldwide research efforts that have generated valid and reliable evidence that certain interventions lead to quantifiably positive financial results for government within predictable timeframes.

The main categories of benefits to government of early intervention investments are:

- cost savings (i.e., a reduction in existing program spending),
- avoided costs (i.e., a reduction in anticipated program spending), and
- increased tax revenue (i.e., an increase in the amount of tax revenue generated by government from the populations benefiting from the early intervention investment).

At least initially, benefits to a government of an early intervention investment would essentially be foregone costs. That is, early intervention would result in the reduction of future costs in the form of lower “upstream” costs relating to late intervention and emergency services, ultimately reducing the

costs to the Canadian welfare system. In addition, the served individuals will be more likely to be productive citizens and, thus, future taxpayers than would be the case without the intervention. Only interventions for which objective evidence-based research exists to support the assertion of future cost savings would be considered for treatment as assets.

View B – Early intervention investments do not meet the definition of an intangible asset but do more generally meet the definition of an asset

Proponents of this view agree with the arguments as to why an early intervention investment would meet the definition of an asset set out in View A. However, they argue that the definition of an intangible asset in existing accounting standards and literature would not be met by an early intervention investment. Thus, the recognition prohibition relating to intangibles in Sections PS 1000 and PS 1201 would not apply to early intervention investments and they can be considered for recognition as assets in public sector financial statements without having to rebut the presumption that they cannot be measured.

IAS 38 and IPSAS 31 require that an intangible be identifiable and meet the definition of an asset in order to be recognized as an asset in financial statements. But the term “identifiable” in these standards is not used in the common sense of the word as set out in View A. IAS 38 and IPSAS 31 provide specific guidance on what identifiability means:

“An asset is identifiable if it either:

- (a) Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- (b) Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.”

An early intervention investment does not meet the identifiability requirements of these standards and, thus, cannot be accounted for as an intangible asset.

Reference to IAS 38 and IPSAS 31 is made because these are the most relevant aspects in other financial reporting frameworks to the issue under discussion. IPSAS 31 is a public sector standard; however, it is substantially based on IAS 38 and does not specifically consider uniquely public sector intangibles.

The submission considers early intervention investments as most resembling an intangible asset like a patent. However, it is conceivable that early intervention investments may instead resemble other assets including prepayments, financial assets or other asset categories which allow for investments to reduce or avoid future cash outlays by government or increase tax or other revenues to it.

View C – Early intervention investments do not meet the definition of an asset

Proponents of this view dispute the arguments under Views A and B that an early intervention investment is a controlled economic resource and regarding how an early intervention investment provides future economic benefits that are expected to be obtained by the investor entity.

Future economic benefits in the form of future cost savings are projections based substantially on existing and future government intentions. Spending by the same government in future years or spending by a different government on the upstream later intervention costs is being assumed in asserting that there will be future cost savings from an early intervention investment. Calculating the extent of future cost savings poses various questions that may leave room for significant flexibility in the calculation and attribution of future cost savings to an early intervention investment and, thus, the nature and extent of the future economic benefits to be realized by the investor.

- How are the projected savings to government calculated? What specific future costs will be expected to be reduced by the early intervention investment?
- What is the benchmark against which one would assume that the government has reduced its future costs? Are any or all of those (projected/estimated) future costs avoidable? Are any or all of those (projected/estimated) future costs legally or morally required to be incurred by the government? How easily can an early intervention program for which an early intervention investment exists be cancelled? How easily can the government decide not to incur the expected upstream later intervention costs?
- Would the benchmark against which one would assume that the government has reduced its future costs vary by type of early intervention investment?
- Assuming reduced future outlays also inherently assumes that future outlays for the particular issue, such as autism services, and related issues, such as emergency and other health-related costs, will continue to be made. If reduced future outlays are benefits that help justify asset recognition of an early intervention investment by a government, do the projected future outlays also comprise an obligation that meets the definition of a liability for the government? That is, if the benefits of reduced future outlays are expected to be realized, then the obligation to make those future outlays must also be expected to be realized.
- And how direct are the actual benefits to the government of an early intervention investment? Is it possible to separate out and attribute the benefits of an early intervention investment between the government and the served population?
- What kind of outcome would be needed as a “product” in order to support asset recognition? Is a consistent product possible from an early intervention investment? For example, is the expected outcome a general societal one or a measurable impact per individual served by an early intervention investment program? Does the impact on each individual need to be consistent or is variability in the product acceptable?
- Are positive outcomes assumed because of a program’s intent and asset recognition is based on the intended benefits? Alternatively, is proof of success/outcomes after the fact appropriate to support asset recognition at the time of investment?
- Would the evidence only have experience characteristics – i.e., the benefits are only evident after the treatment has been experienced and only evident to those who experienced it – or will the benefits be externally observable/testable?

- Are the benefits traceable – i.e., can they be attributed to each individual in the population served by the early intervention investment program or just more generally to the population as a whole? Will all products/outcomes of an early intervention investment have conformance quality – i.e., would they each be expected to meet the same minimum/maximum/established criteria set for them?
- What does the outcome look like? What does a high-quality outcome look like as opposed to a marginal outcome? Are only early intervention investments that are expected to produce high-quality outcomes able to be recognized as assets? If so, what distinguishes a high-quality outcome from a marginal one and why is this one of the factors that would determine if asset recognition is appropriate? Or would this distinction just be an asset quality issue that might impact impairment assessments?
- Is the same spending required each year to achieve the intended benefits to a new population? If the spending is required every year and the amount is similar every year, would capitalization and amortization just add work and cost but not value? That is, shouldn't setting up a database to track the investments and amortize them over future periods need to add value or provide some demonstrable benefit?

In addition, an early intervention investment does not share other characteristics of assets, even if those characteristics are not essential for financial statement recognition of an asset.

- An early intervention investment cannot be sold or transformed or licensed, rented or exchanged. The benefits related to an early intervention investment cannot be transferred to others or even back to the government. It may be possible for a prepayment of the costs of a three-year program to an external provider of the program to be recouped by the entity if the program is cancelled or significantly amended but such a possibility would probably need to be set out in the related contract with the provider. As a future event, such a receivable would only be recognized as an asset by the government when it is expected to be realized.
- An early intervention investment does not have an alternative use.
- An early intervention investment is not in physical possession of the government because it is intangible. And the intellectual capability fostered in the served population belongs to those individuals, not the government that made the early intervention investment.

View D – Early intervention investments are an investment in human (and perhaps social) capital and reporting on them should be provided outside the financial statements

This view asserts that asset recognition of an early intervention investment is not theoretically supportable and that these types of investments would better qualify for required supplementary (stewardship) reporting. Early intervention investments would still be reported and visible but not as assets in the financial statements.

The Group's Discussion

One Group member indicated that government spending on programs of early intervention are in fact a form of insurance rather than an investment. The number of individuals with a particular condition normally represents a fraction of the population of the jurisdiction. The government has programs to help with such conditions because the average citizen cannot afford the help on their own. The public good provided is not an investment but insurance that reduces the possible risk to an individual citizen. The public good is not the treatment but the insurance that if an individual has a particular condition, this program will exist to help them. A government chooses such spending after considering the costs and benefits of the various forms of help that could be efficiently provided. The intent is not to purchase an asset.

Another Group member continued this theme by indicating that choosing to incur lower costs sooner rather than higher costs later is the right choice but such choices do not create assets. Another also agreed that such spending does not comprise an asset and differentiated it from the spending to acquire a traditional tangible capital asset. Further, evidence-based decision making was strongly supported but some Group members indicated difficulties with considering opportunity costs as this focus had the potential to distort decision making.

It was noted that it is the nature of government to provide services and that spending on programs for policy reasons is integral to that service provision. So if some program spending is capitalized, that accounting might blur the accountability for spending that the public demands. A couple of Group members suggested that value-for-money evaluations may be a better tool for encouraging early intervention programs. Another agreed, indicating that drawing the line between government spending to be capitalized as investments and other spending may be difficult and arbitrary even if there is rigour around the evidence needed to support asset accounting of an early intervention investment. Allowing such a distinction might create an incentive to try to fit within the criteria for capitalization.

Group members also traded comments about the aspects of the asset definition and whether an early intervention investment was controlled, the impact if served individuals left the jurisdiction, whether the benefits would be attributed to the served individuals or the government, etc. Examples of intervention programs in various jurisdictions, such as vaccination programs, were cited as examples, but concerns were expressed about the appropriateness and viability of recognizing such programs as assets. Social impact financing was identified as a related issue to early intervention investments and perhaps a topic for future Group discussion.

One Group member commented that if suitable methodologies do not exist to support all intervention programs as evidenced-based early intervention investments, then there could be an unintentional bias to invest in those programs that do have sufficient research to support asset recognition over those that do not have such research (for example, in autism programs over Alzheimer's programs). In addition, given that government often intervenes in the economy, in the health and welfare of its citizens, etc., there may be an unintended result of loading up the statement of financial position with capitalized spending for future amortization and the meaning of the results statement will be compromised.

Another Group member indicated that it is very challenging to distinguish such transactions from government transfers. Early intervention investments represent a more efficient and evidence-based

way to provide public service. Rendering better public service helps the target population. The early intervention investment scenario is comparable with how a government transfer never results in a prepayment or an asset for the transferor. It is the target population that garners the future benefits once the investment is made. In that sense, it is consistent with a common conceptual challenge of differentiating the government from the population of its jurisdiction.

The topic appears to touch on aspects of “intergenerational” or “inter-period” equity. As explored in PSAB’s current Conceptual Framework project to date, this concept poses the question of how best to match expenses with ultimate period(s) of benefits. Ultimately, deferring and spreading over time the impact of early intervention investments would meet such an objective. However, the existing and proposed asset and liability-based reporting model does not have intergenerational or inter-period equity as an objective and does not assume that every government has such an equity objective either, as having such an objective would be a government policy decision.

Some Group members noted that early intervention information, including the success of such programs, is useful information but the current standards would likely limit how such information is shared. Having alternative reporting as suggested in View D would allow flexibility in the form, level of detail and measurement basis.

The Group concluded that it is a really early stage in the discussion of issues like early intervention investments. There are some theoretical, practical and communication issues to resolve. If early intervention investments do qualify as assets, then putting a verifiable value on them would be an issue. Good data and good valuation techniques would be needed. The existing historical cost model may be a barrier. The public may not yet be willing and able to understand the line that would need to be drawn between such investments and other government spending. The public would need to understand why this spending is unique and requires asset accounting in comparison to other government spending.

Standard setting is evolutionary. The Group would welcome further discussion of this issue in the future.

The remaining issues from the submission were not specifically discussed by the Group given the consensus that financial statement recognition of early intervention investments as assets is not supported at this time.