

PSAB/Asset Management

NEWSLETTER NO. 60

THE NEXT FRONTIER IN MUNICIPAL ACCOUNTING? - International Financial Reporting Standards (IFRSs)

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**This Newsletter has been made available as a result of financial support from the
Province of Ontario**

Through this series of PSAB Newsletters, we have tried to assist you in implementing tangible capital asset accounting, and the financial reporting changes for Canadian municipalities that came into effect on January 1, 2009. The new financial reporting model that TCA accounting supports is probably the most significant change in the accounting history of any Canadian municipality, even the long-incorporated ones.

Now that you have your TCA accounting under control and are gearing up to produce a revamped financial report for 2009, many of you are probably wondering what the next major future municipal accounting change will be. - - Perhaps so that you can start to deal with it, and face it head on????

There will certainly be changes from time to time to the PSAB standards, Government Transfers (PS3410) being the next likely one to be approved by PSAB. Generally, these will not be difficult or labour-intensive to implement. The replacement of Canadian generally accepted accounting principles (GAAP) for public sector financial reporting with the International Financial Reporting Standards (IFRSs) would be a major accounting change on a par with what we have been going through currently, and could be a major challenge for a municipality to implement.

Currently, this is often considered a non-issue, as being something too far down the road to even think about... But if the world is gradually and steadily marching towards a version of these standards, how long can we stay out of step? The Accounting Standards Oversight Council (AcSOC) has already made comments to the effect that PSAB should consider convergence in light of what is happening with the convergence of commercial accounting with IFRSs.

The International Public Sector Accounting Standards Board (IPSASB) is developing a conceptual framework that takes into account the unique nature of governments. While their objective is to use IFRSs wherever possible, they do recognize differences in the nature of governments. Thus we may well see convergence with international public sector standards, rather than outright adoption. It could be mutually beneficial if local governments kept abreast of developments in the international public sector, as a way to potentially influence future Canadian standards.

As to when convergence or a move towards IFRSs may occur in Canada, that is anyone's guess. It is the author's personal opinion that this will not occur before 2020 at the absolute earliest, and probably with a lengthy implementation period, as was the case for TCA accounting, even if most of us did wait till the last year or two. In short, IFRSs are something that you may want to be aware of, but it is not something to be overly concerned or bother about for your municipality for a long time to come.

Let us take a brief look at what IFRSs are.

International Financial Reporting Standards

IFRSs are the culmination of an initiative started by the International Accounting Standards Board in 1973, to move towards a single set of accounting standards and principles used world-wide. Under the aegis of the local standard-setting body (Canadian Accounting Standards Board in Canada or CSAB) each country has traditionally set its own standards, or generally accepted accounting principles (GAAP). For example, there could be substantial income differences between Canadian GAAP and US GAAP. US GASB 34 is much more prescriptive than our PS3150, likely resulting in different valuations for asset inventories. Same landscape, but different perspectives.

IFRS has been adopted by over 100 countries around the world. The European Union and Australia required public companies to use IFRS in 2005, New Zealand in 2007, and India and South Korea, among others, starting in 2011. China and Japan have taken the position to converge their standards to IFRSs, rather than adopt IFRSs, a fine distinction, perhaps, so that honour is satisfied(!) On February 13, 2008, the Canadian board decided to make IFRSs mandatory for all publicly accountable Canadian enterprises starting in January 2011. The United States is currently targeting an implementation date for IFRSs around 2015.

While there has always been considerable reluctance to give up national accounting standards, globalization and global companies, plus the Enron and other corporate collapses of the past decade, and what has been happening in the past 18 months, have all served to promote the need for a single set of high quality standards which can be applied throughout the world. These events have also prompted a demand for a much greater degree of disclosure or transparency in financial reporting.

While IFRSs may have some local flavours or variations, the CICA is taking a full adoption approach that come 2011, IFRSs will become Canadian GAAP for publicly accountable or traded enterprises. However, note that Canada will not be adopting IAS 26 which is a standard related to pension plans and how the pension plan will account for all its activities. There may well be other variations.

CASB excludes from this reporting requirement privately-held enterprises, not-for-profit organizations, and **public sector entities to which the standards contained in the CICA Public Sector Handbook apply**, (from the CICA Exposure Draft on "Adopting IFRSs in Canada", April 2008). The March 2009 Version II of this exposure draft reconfirms this, and notes "*private enterprises and not-for-profit organizations will be permitted to adopt IFRSs once they have been included in the Handbook, but will not be required to do so.*" (sub-paragraph (c), page ii). For them, adoption will be optional.

Thus Canadian municipalities are specifically exempt from adopting IFRSs, and this major change in accounting standards does not apply to them. At least not yet!

Think about the implications of this change, especially in the context of the current state of economic affairs around the world. How can national governments compare their actions, results and performance if each is using a different set of accounting standards? Closer to home, how willing will your investment underwriter be to try to analyze your municipality's financial statements prepared under Canadian public sector GAAP, when all their other clients report using IFRSs? Or if someone wanted to do public/private comparisons?

Just as there is a convergence in reporting taking place for publicly traded organizations around the world, there will be pressure for the public sector to report on a similar convergent basis, both nationally and internationally. You have already been experiencing this in Canada with the move to tangible capital asset accounting, which now is similar to private sector practice.

Two other possibilities will promote change as well. If a municipality seeks to raise capital funding outside of North America, the financial houses overseas will likely take much more kindly to financial reports prepared using IFRSs. Similarly, if buying major equipment outside North America, the supplier company may have difficulty understanding a financial report that does not conform to IFRSs, and that may impair the deal.

These sorts of subtle pressures are why the implementation of IFRSs across the Canadian public sector, probably a public sector version, seems inevitable eventually. The time horizon for adoption in whole or in part is probably at least ten years away, at the minimum.

If and when it happens, what will be involved?

Implementing IFRSs

There is an 1800-page manual available that documents IFRSs in detail. Here we will talk about some of the key concerns that you may have.

Ironically, the implementation of TCA accounting and the new financial statements will position you well for IFRSs, as the IFRS statements are quite different in layout than current corporate statements. For example, the Balance Sheet will be replaced by the Statement of Financial Position, which is similar in layout to the new Consolidated Statement of Financial Position which you will prepare for your 2009 statements. The IFRS Statement of Comprehensive Income is analogous in layout to your Consolidated Statement of Operations, and so on.

TCAs are dealt with at length in Standard #16 (IAS 16). You can have as many asset classes as you want, just as PS 3150 allows you. However, components of fixed assets with different lives must be accounted for separately. Remember the discussion on disaggregation versus aggregation? IFRSs give you no choice, and if you have disaggregated your assets already, you are well prepared. Be warned that the Standard may require a greater degree of disaggregation than you used. For example, an aircraft should probably be broken into something like 15 components for proper analysis and reporting.

When valuing your assets, IFRSs gives you the choice between using historical cost and the revaluation model, unlike Canadian GAAP. Your choice must be stated in the notes, used consistently, and cannot be changed unless to do so will give better information to users of your statements. And please explain why.

Currently, you start amortizing your TCAs when they go into use for the first time. IFRSs require amortization to start when the asset is available for use. The cube van that you bought for an ambulance is not available for use the day it arrives. The back-up pump you bought is, even though the need to use it has not arisen as yet, and it may still be in its shipping crate in a warehouse.

IFRSs require disclosure about your asset classes, similar to PS 3150.40 to .42, with a few additional items, such as when you acquire or divest a block of assets due to an organization change.

When you borrow to acquire TCAs, IFRSs provide more detailed guidance on how to capitalize interest costs than does the Handbook (IAS 23). However, IPSASB is proposing not to converge with IAS-23, a possible outcome being that borrowing costs are to be expensed unless “specifically incurred”, in order to acquire an asset.

Asset impairments or write-downs are dealt with similarly in IFRSs as in GAAP. However, should the conditions that caused the impairment be reversed, then IFRSs requires the impairment to be reversed in your accounts. PS 3150.33 prohibits such reversals.

Interestingly, Canadian municipalities are now probably better positioned to implement a migration to IFRSs than are most Canadian corporations. You have already worked through many of the issues involved, in order to be ready to prepare your 2009 annual financial report. For the private sector, a building is typically a single asset, as is a vehicle, whether an ocean liner or a bicycle. If you chose aggregation rather disaggregation, there will be a lot more work for you to do than if you disaggregated.

Finally, most noticeable will be the change in your financial statements, because of the greater level of disclosure required. While there are still only four financial statements, it is estimated that IFRSs typically result in much more voluminous notes to the statements. However, you should have the information readily available to provide the extra detail, and will probably have it already, from your implementation of TCA accounting.

Summary

This has been a very brief overview of a major potential accounting change that you may be faced with in the rather distant future. Again, be aware of what IFRSs are, but don't be overly concerned about it, until if and when it is ever adopted in whole or in part for the Canadian public sector.

You should be aware of the PSAB project on revisions to the Introduction to the Public Sector Accounting Standards. This may affect the general accounting principles used by some of your consolidated entities. For example, will your government business enterprises (GBE), if you have any, end up following IFRSs? Will some organizations previously classed as GBEs and government business-type organizations (GBTOs) change their designation under the new definitions proposed? Will not-for-profits follow PSAB Handbook GAAP?

These could be significant changes for municipalities and for their consolidated entities. There is an Exposure Draft currently out on the Handbook Introduction, and another on not-for-profits is anticipated being released this fall. If adoption of public sector IFRSs may be a long way in the future, convergence with IFRSs may be more likely, and much sooner.

Stay tuned!

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As this newsletter goes to press, we are well into 2009, and the year that tangible capital asset accounting goes live for Canadian municipalities. This series of publications was originally designed to assist Ontario municipalities in dealing with the change to full accrual accounting, and especially in carrying out what is required to effectively account for tangible capital assets. From feedback received from all provinces and territories across Canada and from some other countries, they have reached and served a far wider audience than was originally envisaged.

If they have been able to assist you in some small way in your own work in your own municipality, wherever that may be in the world, then its mission is accomplished.

This author would like to express his thanks to the anonymous reviewers who provided invaluable insights and comments that added considerably to the final version of each of the newsletters that MFOA/AMCTO has published.

This concludes this series. All that remains is to wish you every success in completing your own implementation. On time and within budget of course!

For more information and resources regarding tangible capital asset management, go to [PSAB/Asset Management](#) or contact:

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This Newsletter is published to assist you with your implementation of tangible capital asset accounting and with related matters. The Public Sector Accounting Handbook is the only authoritative primary source on matters relating to GAAP, and you should consult with your auditor to resolve specific issues that you may have.