Advisor alert—Section PS 3430 *Restructuring Transactions*

October 2016

Overview

In June 2015, the Canadian Public Sector Accounting Standards Board (PSAB or the Board) issued a new accounting standard, Section PS 3430 *Restructuring Transactions*, dealing with how to recognize, measure, present and disclose restructuring transactions such as: amalgamations between public sector entities, annexations or boundary alterations between neighbouring local governments, and transfers of operations or programs between public sector entities. This new standard provides guidance on accounting for restructuring transactions in order to achieve consistent reporting across the public sector.

Scope

Restructuring activities can be initiated by the public sector entities involved, by a controlling public sector entity or imposed by a higher level of government through legislation. There may be more than one transferor or recipient in a restructuring transaction. The key characteristics of a restructuring transaction are the

- lack of consideration paid based on the fair value of the items transferred, and
- transfer of an integrated set of assets and/or liabilities that is not random or unrelated in that the set is somewhat complete in supporting the program or operation for which the responsibility is also transferred in the restructuring.

These characteristics distinguish a restructuring transaction from an acquisition transaction.

When the fair value of the individual assets and liabilities transferred is unknown and no effort has been made to estimate their fair value, unless there is evidence to the contrary, the transaction is likely a restructuring transaction. A restructuring transaction may include compensation, which is defined as "a payment made in a restructuring transaction by a transferor to a recipient or vice versa that is not based on the fair value of the individual assets and liabilities transferred". For example, recipients in an annexation may agree to compensate the transferor for its loss of future property tax revenue by providing a lump sum payment at the restructuring date that is equivalent to the present value of property tax revenue for an extended period based on the current tax rate and assessment. This payment may be substantial, but does not preclude the transaction from being considered a restructuring transaction because the payment is not based on the fair value of the items transferred.

When a recipient assumes the program or operating responsibility previously performed by the transferor, the transaction is a restructuring transaction, rather than a contribution, gift or government transfer. For example, a public sector entity that receives a building from another entity without providing consideration has received a government transfer. Alternatively, an entity that receives a building AND the transferor's previous responsibility for delivering community programs located in that building has not received a government transfer; rather, the transaction is a restructuring transaction.

Section PS 3430 *Restructuring Transactions* does not deal with the acquisition of a group of assets, an operation or an entity; a contribution of an asset or assumption of a liability; or the disposal and abandonment of assets or discontinuance of operations that is not part of a restructuring transaction.

Recognition and measurement

Transferor

A transferor may continue or cease to exist after a restructuring. Prior to the restructuring, it continues to measure the individual assets and liabilities that will be transferred on the same basis prior to the restructuring date. For example, the transferor does not write down a tangible capital asset that will be transferred in a restructuring transaction simply due to the upcoming restructuring or expected change in use after the restructuring. It only considers any change in the use of the asset prior to the restructuring date to determine whether a write-down is required in accordance with Section PS 3150 *Tangible Capital Assets*.

The transferor should consider whether it has any continuing involvement in the individual assets and/or liabilities it transfers to a recipient subsequent to the restructuring date that may preclude derecognition or may require the recognition of a new asset or liability. For example, if the transferor provides a guarantee of debt repayment on a financial liability that was transferred, the transferor may have to recognize a liability under Section PS 3300 *Contingent Liabilities*.

Recipient

At the restructuring date, the recipient recognizes the individual assets and/or liabilities received at their carrying amounts with adjustments to

- conform with Public Sector Accounting Standards;
- align the accounting policies, methods and assumptions with their own (for example, the discount rate used to calculate a defined benefit pension plan liability); and
- reflect the recipient's circumstances.

The carrying amount of an asset or a liability transferred in a restructuring transaction is the amount reported in the statement of financial position of the transferor at the restructuring date; for example, the carrying amount of a tangible capital asset would be its cost less accumulated amortization and any write-downs prior to the restructuring date.

Both the recipient and transferor

On the restructuring date, the transferor derecognizes the carrying amounts of the assets and liabilities transferred and recognizes the net increase or decrease in its net assets as a separate revenue or expense line item in the statement of operations. The recipient also recognizes and presents, as a separate revenue or expense item, the net effect of the restructuring transaction. Neither the transferor nor the recipient can restate their financial position or results of operations prior to the restructuring date to retroactively report the effects of a restructuring transaction in its financial statements as if the restructuring transaction took place prior to the restructuring date.

Restructuring-related costs include, but are not limited to legal, accounting and professional services costs that enable the transaction; and costs to achieve the objectives of the restructuring, such as terminating and combining programs, relocating and terminating employees and terminating contracts. Both the transferor and recipient must expense these costs when incurred in accordance with the relevant Sections of the Public Sector Accounting Handbook. For example, termination benefits would be recognized as an expense in accordance with Section PS 3255 *Post-employment Benefits, Compensated Absences and Termination Benefits*.

Compensation that is not dependent on future events or transactions is recorded as revenue or an expense at the restructuring date, regardless of when the payment is made. For example, if a recipient in an annexation agrees to compensate the transferor for its loss of future property tax revenue, both parties recognize the compensation at the restructuring date, regardless of whether the recipient will pay the amount in a lump sum or over a period of time.

Disclosure

The disclosure requirements take effect from the date a restructuring agreement is reached through to the period in which the restructuring transaction takes place. Both the transferor and recipient must disclose sufficient information to enable users to assess the nature and financial effects of a restructuring transaction on their financial position and operations.

Some of the disclosures required in the reporting period in which the restructuring occurs include the

- entities involved and the nature of their relationships if there is any control, common control or shared control relationship between them;
- reason for the restructuring;
- restructuring date;
- nature of assets, liabilities and related responsibilities transferred;
- nature and terms of any compensation;
- nature and extent of any contingent liability and contractual obligations transferred;
- nature of any restructuring-related costs incurred;
- nature and, where applicable, terms of other restructuring-related events, arrangements and transactions;

- carrying amount of assets and liabilities transferred and received at the restructuring date by major classifications;
- adjustments made to the carrying amount of assets and liabilities received, if any, and the rationale for the adjustments;
- amount of compensation recognized, if any;
- amount of and the line item in which the net effect of the restructuring transaction is recognized;
- amount of and the line items in which restructuring-related costs are recognized;
- amount of and the line items in which the effects of any restructuring-related events and transactions are recognized; and
- revenue and expenses related to the transferred responsibilities that are included in the statement of operations by major classifications (recipient only).

Transferors and recipients are also encouraged, but are not required, to disclose information about the transferred assets and liabilities, and results of operations related to the transferred responsibilities prior to the restructuring date. The determination of whether this information would be disclosed, as well as the extent and format of such a disclosure, is based on the

- usefulness of the information to the readers;
- materiality of the financial effects; and
- cost associated with and the practicality of providing the information.

If a transferor or a recipient decides that restating the financial position and results of operations prior to the restructuring date as if the restructuring transaction took place since its formation provides useful information for readers, it can only do so in the notes and schedules to the financial statements and must clearly mark the information as pro forma.

Transitional provisions

Section PS 3430 applies to restructuring transactions occurring in fiscal years beginning on or after April 1, 2018. Earlier adoption is permitted. An entity would not go back and restate restructuring transactions that occurred prior to its fiscal year beginning on or after April 1, 2018.

Conclusion

In economic times where many public sector organizations are amalgamating, and governments and government organizations are restructuring to make the best use of their resources, Section PS 3430 provides a single method to account for these transactions which will promote consistent accounting treatment across the public sector. If your public sector entity has entered into a restructuring transaction in the current fiscal period, consider adopting this standard early.

Reach out to your Grant Thornton LLP advisor if you have any questions about this new standard.

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