

February 20, 2004

Ron Salole, CA
Director
Public Sector Accounting Board
The Canadian Institute of Chartered Accountants
277 Wellington Street, West
Toronto, ON M5W 3H2

Dear Mr. Salole:

Re: Exposure Draft: *Liabilities, Contingent Liabilities and Contractual Obligations*

Thank you for the opportunity to provide a response to this exposure draft. We hope that you find our comments useful in your deliberations.

Do you agree with the definition of liability?

While the definition set out in Paragraph .10 is intuitively appealing, we have some reservations.

With this proposed definition it might be expected that financial obligations associated with most statutory payment programs would be treated as liabilities, for example, Old Age Security (OAS). Similarly, equalization payments or treaty rights might also be included under this proposed definition. Additionally would the introduction of new programs, (for example, a joint national childcare program) be considered as liabilities? Taking the obligations approach to its conclusion, there are regulatory programs which establish obligations, regulate and incur costs, and in doing so, would meet all the criteria.

We suggest that the definition could be tightened to ensure that items such as those mentioned above not be included. This would ensure that there is no unintended effect on the user of the financial statements.

Are Paragraphs .20 and .22-.24 in the LIABILITIES proposals needed?

Constructive and equitable obligations are difficult issues; in that there are often co-existing “public” and “confidence” agendas in play at the same time. The accounting office and even program managers may have only limited access to the latter. Expectations may then be inconsistent with reality. With that in mind, the scope for recording constructive and equitable obligations should perhaps be narrowed. Noting that Paragraph .20 is necessary, we would suggest the word “communication” be set in a context along the following lines: “... such that an informed independent third party could reasonably be expected to

rely on that communication, and as a consequence, be prepared to commit to a particular course of action, for example, provide financing, sign an agreement, and so on.”

This approach would still require the exercise of professional judgment, but does narrow the scope somewhat.

While Paragraphs .23 and .24 may be intended to provide further guidance with respect to this “grey” area, the wording of these paragraphs would seem too general. It seems geared to adding a healthy level of scepticism regarding expectations of announced initiatives, as opposed to guidance related to accounting for and reporting on government activity and the use of such information.

It should be noted that with respect to Paragraph .19, where approval of legislation at various stages is to be taken as evidence of acknowledgement of willingness to act, it also may well be construed as evidence that the government does not have the legal mandate to proceed with the course of action. In the federal context, without pending approval by the House and strong evidence of speedy passage by the Senate, it would be unwise to recognize an obligation where government does not have a mandate. In this regard, there are also issues of jurisdictional responsibility (federal versus provincial), which should raise red flags. For example, Provinces have been known to opt out. It is highly questionable whether governments should recognize liabilities where the particular expenditures anticipated would at the time of recording be ultra vires.

Do you think that disclosure of measurement uncertainty should apply to all items recognized in the financial statements?

“All” is too strong. Where the degree of uncertainty is such that the impact of the uncertainty would be material in the context of the financial statements, yes, the disclosure of measurement uncertainty should apply. However, this disclosure should not necessarily apply to “all items.” This will require professional judgment in that a number of individual items may in aggregate be material.

Do you agree that an accrued contingent liability should be derecognized when it is determined that the future confirming event is unlikely to occur?

If such an amount has been recognized on the basis that it was “likely” that the confirming event would occur and that assumption proves to be false, then the amount should be derecognized.

The determination that a confirming event is likely must be based on certain assumptions or information. To the extent that the assumption should prove false, should the derecognition be treated as a current or prior period adjustment? We suggest that it should be the latter to minimize any behavioural biases that the accounting treatment might induce.

Do you agree that the nature, extent and timing of expenditures related to contractual obligations should be disclosed?

Yes, to the extent that the amounts may have a material impact on future cash flows or as a basis for measuring contract performance or where the contract engenders public interest (for example a major National Defence procurement contract). Again, this should be a matter of professional judgment.

Further comments

The financial soundness of governments at any level is generally considered to be based on taxation room/capacity, debt load and related servicing costs and its “obligations,” whether they be in the nature of

trade or in the form of program obligations. In this context, the obligations approach being taken to defining and recording liabilities has great intrinsic appeal. However, the change in reporting may have the unintended effect of shifting the focus and perhaps even public debate from current results to the long term financial sustainability of the existing structure of government services.

Finally, you may wish to revisit this item in context of the International Federation of Accountant's Public Sector Committee's related work on Social Policy Obligations issued January 2004 for invitation to comment.

Regards,

[Original signed by:]

Anthony Ariganello, B.Comm, CGA
President & COO