Practice Standard: Present Value Technique

Background

The Office of the Comptroller General (OCG) has reviewed the use and application of present value techniques in accounting for past events and transactions within the government's reporting entity. The review indicated that while most entities were applying a present value technique consistent with accounting standards, the discount rates used in the calculations vary.

Principle–Based Guidance

This guidance is based on key principles impacting discount rates and present value techniques for reporting accounting transactions. These principles include:

- *A present value technique is appropriate to use when the amount of future cash flow is known, and timing of disbursement extends over a long period*
- *A present value technique should be used when it results in a material change*
- *A present value technique is appropriate to use when the calculation results in the best estimate of an asset or liability at the financial statement date*
- *Return on assets rate is linked to the investments or funding formula*
- *Cost of borrowing is based on a rate of Province of BC borrowed funds*

Key consideration points when determining whether to use PV techniques

Ministries and entities should consider the following when deciding whether to use a present value technique to estimate a long–term asset or liability.

1) Is the account material to the ministry/entity?
2) Is the time horizon significant enough to result in a material impact?
3) Is the period of cash inflows/outflows defined?
4) Does the current value approach provide a reasonable, auditable estimate?
5) Is there a requirement in regulations to use a present value technique or a particular discount rate?
6) Is a future obligation funded by specific assets with an available, reliable rate of return?
7) Has the ministry/entity set a precedence for using a specific present value technique for the asset/liability?

Materiality

When deciding whether to use a present value technique for a long–term asset or liability, the government entity should consider whether discounting the related asset or liability would result in a material impact on the balance. Materiality will vary depending on the entity.

To determine materiality, the entity should consider the following:

- Whether the value is material for the entity
- Whether the asset or liability is stand alone or in aggregate with other transactions resulting in a material balance
- The reasonable expectation that the value or time duration will not change and therefore, become material before settlement
- Whether the entity has set a past precedence that the asset or liability will be discounted; Once the present value technique has been applied, it should continue.

Where the impact is determined to be immaterial, an estimate of the expected impact should be calculated, documented and retained by the entity.

Time Duration

When determining whether discounting should be applied to a particular asset or obligation, the duration to settle the related asset/obligation should be considered. If the duration is short–term, discounting would not likely have a material impact on the value. It is also important to have a reasonable expectation on the duration to settle the asset or obligation.

When the expected time duration is less than 5 years, it is likely that the asset/obligation should not be discounted. When the expected time duration is greater than 5 years, professional judgement should be used when determining whether the value would be materially enhanced by using a present value technique.

Discount Rate

There are three rates referred to in accounting guidance appropriate for discounting:

➢ Rate of return on assets to be used when:
  - a specific obligation is fully funded (e.g., pension plans), or
  - regulations are issued directly related to the asset or liability.

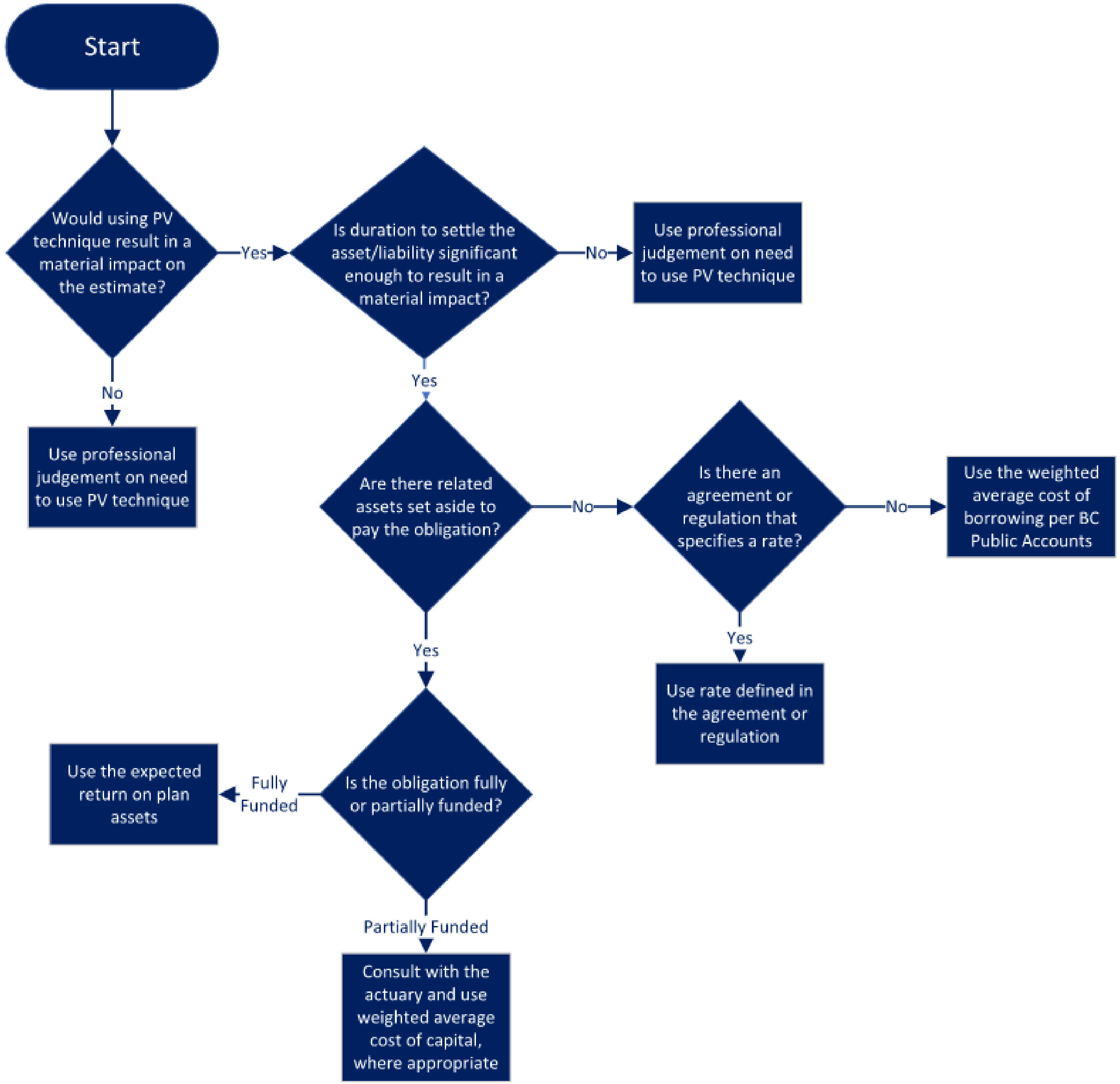
➢ Contract rate to be used when:
  - there is a specific agreement or contract related to the asset or liability (e.g., P3 obligations and capital leases).

- Cost of borrowing to be used in all other cases.
    - the cost of borrowing for the Province of BC is the weighted average cost of taxpayer-supported debt. This rate can be found in the Public Accounts – Taxpayer-supported debt note and is updated quarterly by Provincial Treasury.

Exceptions to the Guidance

If an entity identifies the need to use a different rate than the rates defined above, the entity **must** consult with OCG and receive an exception approval prior to using the rate. To request an exception, the entity **must** document its rationale and provide a copy to Financial Reporting & Advisory Services, OCG (summary@gov.bc.ca).

Please note that these rates may not be appropriate when considering future-oriented decisions, such as lease versus buy, or P3 arrangements. Your Chief Financial Officer can assist in confirming appropriate use.


Start
Would using PV technique result in a material impact on the estimate?
Yes
No
Use professional judgement on need to use PV technique
Is duration to settle the asset/liability significant enough to result in a material impact?
No
Use professional judgement on need to use PV technique
Yes
Are there related assets set aside to pay the obligation?
No
Is there an agreement or regulation that specifies a rate?
No
Use the weighted average cost of borrowing per BC Public Accounts
Yes
Use rate defined in the agreement or regulation
Yes
Is the obligation fully or partially funded?
Fully Funded
Use the expected return on plan assets
Partially Funded
Consult with the actuary and use weighted average cost of capital, where appropriate