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Government Transfers: Implementation Discussion

July 2011
Ministry of Education

Purpose

- The Ministry of Education (Province of Ontario) is seeking to confirm our interpretation of PS 3410, Government Transfers, prior to providing guidance to the 72 district school boards.

- The following points will be presented:
  1) School board financial reporting background information
  2) Proposed treatment of government capital transfers
     a) Land
     b) Buildings
        i. Rationale re: liability (retroactive/prospective)
        ii. Does capital funded through local taxation qualify for DCC?
     c) Minor Tangible Capital Assets
        i. Rationale re: liability (retroactive/prospective)
  3) Proposed treatment of non-government capital transfers

- We are seeking consensus on the points above, and in particular, the local taxation approach.

Background

- The Ministry has reviewed the financial compliance framework in the Education Act and regulations, and made changes to modernize this framework, effective September 1, 2010:
  1. Updates to school board budgeting requirements to align with provincial accounting standards (PSAB);
  2. New financial accountability controls based on financial results; and
  3. New provisions related to multi-year deficit management strategies and recovery plans.
- The goal is to have boards do their budgets and financial statements under the same accounting method, i.e., accrual-based PSAB standards. The legislative changes were designed to accomplish this with minimal exceptions (part of new compliance model).
- Prior to those changes, the Education Act operated on a different basis.
  - Modified cash accounting basis.
  - Inconsistency between boards' budgeting practices and its audited financial statements.
  - Lack of transparency – financial decisions could impact Education Act budget compliance and financial reporting quite differently.

Policy Review - Capital

- The Ministry undertook a review of the capital funding model which was based on a long term debt support model.
- This model was introduced at a time of using modified cash basis accounting.
- With the requirement to report TCA and in preparing for the outcome of the government transfer standard (then at Exposure Draft status), the Ministry identified a need for:
  - A simplified model in funding capital.
  - A new legislative framework on budget compliance (outlined in previous slide).
- Introduced a capital review process to wrap up the old model and fund new capital on a capital grants basis.
  - See Appendix A for more information on the Capital Wrap-Up process.

Financial Reports

2009-10 Financial Statements:

- Boards implemented recent PSAB standards in 2009-10 when capital assets were reported in the Audited Financial Statements.
- Completed the capital wrap-up process, and recognized all outstanding capital debt relating to funded programs (in excess of $8B).

2010-11 Estimates

- Implemented deferral method on capital funding (deferred capital contributions - DCC).
- Now on new compliance model (i.e. the budget is generally aligned with PSAB accounting).
- Ministry is currently revising the forms in preparation of the 2010-11 Financial Statements and in light of the recently released Government Transfer standard (PS 3410).

PS 3410 - Implementation

- The Ministry would like to implement the provisions of PS 3410 retrospectively rather than prospectively:
  - To ensure that the Financial Statements are relevant, understandable to the user, and comparable over periods, consistent with PS 1000.24.
  - To be consistent with the implementation of TCA.
- To meet the criteria above, the Ministry is of the opinion that <u>all</u> capital transfers, regardless of the source, should be treated consistently.
- Retroactive application would require clarification/agreement on the how the Ministry is proposing to treat the opening balances of the DCC account relating to:
  - Buildings
  - Minor TCA (Furniture and Equipment)

IMPLEMENTATION and ISSUES

Land

Implementation – Non-depreciable assets (Land)

- Per the updated standard, capital transfers relating to non-depreciable assets would be recognized in revenue once the asset is acquired (paragraph 3410.27).
- This creates in year surpluses that are not available for future operating purposes.
- The treatment of non-depreciable assets (ex. land) in PS 3410 is different from the current implementation in the 2010-11 budget forms.
  - The Ministry will comply with the standard for the 2010-11 Financial Statement forms re: non-depreciable assets.

IMPLEMENTATION and ISSUES

Buildings: Liability

Liability

- The Ministry is of the opinion that the boards have an obligation with respect to the capital transfers they receive to acquire or develop TCA for use in providing services over the service life of the asset.
- Further, the Ministry believes that this obligation meets the definition of a liability per PS 3200.
- It is Ministry's position that all capital grants provided in the past and going forward relating to buildings and additions create a liability, which allows for deferral of the capital transfer over the life of the assets.

Implementation – Buildings

- The Ministry has the following legislation/regulations in place, which demonstrate the obligation:
  - Education Act 170(1)6
    - Boards are obliged to provide adequate accommodation.
  - Ont. Reg. 193/10, Restricted Purpose Revenue regulation
    - Proceeds of the sale of real property must be used to fund future capital purchases, irrespective of the initial source of funding.
- The Auditor General of Ontario made the following comments in the 2009-10 public accounts:
  - " In assessing the proposed standard against the purpose and nature of the capital transfers received by the province and its fully consolidated organizations, we concluded that, because the ultimate purpose of the transfers is to <u>construct or acquire assets that provide services to the public over their useful lives</u>, it is therefore appropriate to <u>recognize these capital transfers in revenue over the useful life of the related acquired or constructed asset</u>."
  - This is consistent with PS 3410.23(c), where deferral of the capital transfer is permitted when the asset is used "in providing services for a defined number of years".

Liability: PS 3200.05 (a)

- *"responsibility to others"… "little or no discretion to avoid settlement"*
  - *Per Education Act 170(1)6, the board has a duty "to provide adequate accommodation".*
- Capital transfers are provided for pupil accommodation, not to just build a school.
- Boards do <u>not</u> fulfill their duty at the moment construction of the school is complete.
- The board has an implied duty to keep the school in service over its useful life, evidenced by school operations funding being provided to maintain and operate schools.
- Any proceeds on disposition are legislated to be used for other pupil accommodation (O. Reg. 193/10).
- A board cannot not sell, lease or otherwise dispose of a school site or property, or demolish a building unless Ministerial approval has been provided (Education Act 194(4)).

Liability: PS 3200.05 (b)

- *“provision of goods or services”… “settlement at a …determinable date”*

- The capital transfers provided by the Province are meant to provide the service of pupil accommodation. Such transfers are approved after careful review of a board’s accommodation needs for pupil places.
- The stakeholders (Ministry, trustees, parents, students) expect pupil accommodation to be provided over a number of years with sustainable enrolment.

Liability: PS 3200.05 (c)

- “transactions obliging the government have already occurred”

- Boards are required to submit a capital plan to the Ministry. This includes:
  - Key information on existing capacity
  - Enrolment projections
  - Program offerings
- Capital plans are only approved if there is an enrolment forecast that shows that a school is needed at a particular location for a sustainable period of time to service the community.

Liability: PS 3200

- The capital transfer appears to meet the definition of a liability per PS 3200, thus the Ministry plans to instruct boards to recognize capital transfers in revenue over the service life of the asset.

IMPLEMENTATION and ISSUES

Buildings: Local Taxation

Local Taxation Background

- Prior to 1998, school boards had taxing power and as a result, some of the capital acquisitions were funded from local taxation.
  - Prior to 1998, boards received some provincial capital grants, but they also raised taxes for operating and capital purposes.
  - 1998 and beyond, boards no longer have taxing power; the Province sets the tax rates.
  - Funding is a provincially determined allocation-based model and boards have limited ability to raise funds for locally determined needs.
- This poses some implementation challenges in determining the opening balance of DCC.
- The funding of depreciable assets (buildings) needs to be analysed based on:
  - Pre-1998 funding
  - Post-1998 funding

Opening DCC Balance: Local Taxation

Question: Can tax revenues used to support capital be included in the opening DCC balance?

- Generally, PS 3510 (Tax Revenues) would be used to determine how to account for this revenue source.
- The Province and school boards have a unique set of circumstances whereby it may be appropriate to include these amounts in DCC.

Background: Pre-1998 Capital Funding

- Prior to the introduction of the funding model in 1998, the Province provided capital grants to school boards to fund their capital projects.
- Boards also funded part of their capital projects through local taxation since they had taxing power pre-1998.
- Most boards long term financed the local share of their capital projects and raised annual taxes to meet the debt servicing costs of their capital debt.
- The Province recognized pre-1998 capital debt through annual debt support grants through the funding model since 1998.
- The outstanding amounts of that debt have been recognized as revenue as part of the 2010 appropriation for eligible capital debt (capital wrap up).
- The Province has effectively taken responsibility for the boards’ major TCA; therefore, readers of the statements should see this through the implementation of DCC.

Background: Pre-1998 Capital Funding Cont.

- Prior to 1998, proceeds from sale of real property were placed partly in a Ministry capital reserve and partly in a board capital reserve.
- The part that was in the board capital reserve represented the local share portion of the proceeds for the board to use for their local capital needs.
- The part that was in the Ministry capital reserve represented the portion of the proceeds that belong to the Ministry. Boards could not access this reserve without Ministry approval.
- The Province introduced a new regulation in 1998 that imposed restrictions on proceeds of disposition of real property.
  - The restriction was on the whole proceeds, with no distinction on how the assets were funded.
  - Effectively, the board and Ministry capital reserves were now under the control and responsibility of the Ministry.
- The regulation requires those proceeds to be used for school sites (or minor capital assets). Use of the proceeds of disposition requires Ministry approval.

Summary: Pre-1998 Capital Funding

- The control structure changed significantly such that even pre-1998 assets became the responsibility of the Province.
  - The financial statements should reflect this.
  - Retroactive restatement is necessary to ensure that the Financial Statements are relevant, understandable to the user, and comparable over periods.
- Even though the boards used local taxation to fund some of their capital, the debt related to these assets was <u>fully supported by Provincial funding</u>.
- Regulatory changes have resulted in extensive government control on school board assets, irrespective of how the assets were initially funded.
- In consideration of the above, the Ministry believes it is appropriate to include the opening balance related to tax revenue contributions in DCC.

IMPLEMENTATION and ISSUES
Furniture, equipment and other minor TCA

Furniture, equipment and other minor TCA

- The Ministry has and continues to provide funding for mTCA.
  - Prior to fiscal 2010-11, the Ministry provided grants intended to be spent on both operating and capital amounts.
  - A portion of the grant was meant to cover mTCA; however, the amount to be spent on capital was not specified.
  - The portion of the grant that was used for mTCA was disclosed in both the budget and financial statements.
  - Additionally, a portion of the mTCA was funded through Ministry capital grants (i.e. in the case of first-time equipping of schools).
  - Per PS 3410.21, where the stipulations of the transfer are too broad to create an obligation, the recipient government would review its actions and communications to evaluate their substance and intent.
    - In this scenario, the nature and extent of the actions and communications, together with the transfer stipulations created a liability for the boards since they used the transfers to purchase minor TCA.

Furniture, equipment and other minor TCA

- On a go forward basis, the Ministry has made regulatory changes to meet the requirement of PS3410 in regulation "Grants for Student Needs" (GSN).
  - The Ministry now provides a distinct grant for minor tangible capital assets such as vehicles, furniture, equipment, computer hardware and computer software.
- Per the Education Act, s.170(1)8, boards have a duty to "provide suitable furniture and equipment".
  - Boards have a liability with respect to transfers received for mTCA, which is discharged over their useful lives.
- The Ministry is proposing that the NBV of the mTCA as of September 1, 2010 be part of the opening balance of deferred capital contribution.

Furniture, equipment and other minor TCA

- These assets are of a service life that range from 5 years to 10 years. Therefore, they have all been acquired after 1998, when boards no longer had taxing power, the allocation-based funding model was introduced by the Province, and taxation rates were set by the Province.
- In light of the above, the Ministry does not think that the local taxation issue raised in the opening balance for buildings is applicable to mTCA.

IMPLEMENTATION and ISSUES

Non-government capital transfers

Non-Government Capital Transfers

- Boards receive some third party capital transfers:
  - Donations (ex. for playground equipment).
  - These are generally non-material amounts.
- PS 3100.11 *"Externally restricted inflows should be recognized as revenue in a government's financial statements <u>in the period in which the resources are used</u> for the purpose or purposes specified."*
- 3410.23(c) *"for use in providing services for a prescribed number of years"*
- The Ministry interprets "for use in providing services for a prescribed number of years" as "in the period in which the resources are used".
  - The "resources" are "used", i.e. amortized, over the life of the asset.

Applying Guidance in PS 3410 to PS 3100

- Prior to the implementation of TCA, boards were expensing their asset purchases.
  - Thus, the revenue associated with these assets was recognized immediately.
- Now that assets are capitalized and amortized, one must reconsider the interpretation of PS 3100.11, especially in light of the changes to PS 3410.
- Consistent with the Provincial Public Accounts, it is the Ministry's interpretation, that third party capital transfers which were intended to be used to provide service over the useful life of the asset can be recognized into revenue over the useful life of the asset per PS 3100.

Closing Remarks

- With respect to the implementation of DCC per PS 3410, the Ministry of Education is seeking consensus on the local taxation approach, allowing for the inclusion of tax revenues in DCC.
- There was a change in governance around capital that occurred in 1998, resulting in the Ministry having control over the boards' capital assets.
  - The financial statements should reflect this.
- Applying DCC for some capital transfers and not others will result in financial statements that are excessively complex, and would not serve the users well.
- Since TCA was required to be implemented retroactively, DCC should also be implemented retroactively for comparability.
  - This will require professional judgement in determining the opening DCC balance.

Appendix A: Capital Wrap-Up

- Prior to the Capital Wrap-Up, boards received funding for new schools and additions on a yearly basis, to cover debt support payments:
  - The funding was smoothed over 25 years.
  - This was a very effective mechanism for its time since capital was not amortized and budget compliance was on a modified cash basis.
  - Boards typically long-term financed the capital construction costs and repaid the debt with the 25 year grant allocation stream.

- Capital debt was wrapped up through a one-time grant that recognized all the existing capital debt as of August 31, 2010 ($8.6 billion), on approved capital expenditures.
  - This grant is being flowed to boards over the remaining term of their existing capital debt instruments.
  - This created a one-time appropriation of $8.6B and payable in the government books.