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Modernization of the Financial Accountability Framework

September 2009 (abridged March 2010)
Ministry of Education
Fall Information Sessions

Purpose

To explain upcoming changes to the Financial Accountability Framework, including:

- Two key accounting standard changes
  - PS 1200 Financial Statement Presentation
  - PS 3150 Tangible Capital Assets
- Four key Education Act changes

Accounting Standard Changes

- The goal to align the Financial Accountability Framework to PSAB is influenced by two new PSAB standards.

  1) PS 3150 requires boards to report their tangible capital assets (TCA).

     - TCA are to be reported as assets on the statement of financial position.
     - The amortization of TCA should be accounted for as an expense in the statement of operations.

  2) PS 1200 and PSG-4 replace the concept of reserves.

     - Information on funds or reserves can only be in the notes and schedules - not on the statement of financial position.
     - Key concept: The creation of, addition to or deduction from funds and reserves does not create a revenue or expense, and would therefore not be reported on the statement of operations.

- Both sections apply to school boards for fiscal years beginning on or after January 1, 2009. Thus, boards will be implementing these changes in their 2009-10 financial statements.
- Since PSAB is an external standard setter, boards must comply with these timelines.

Implication for Tangible Capital Assets (TCA)

- Since boards' financial compliance will be based on PSAB financial reporting, it is important that the new accounting standards are implemented in a way that provides meaningful financial information.
- When TCA are put on the financial statements in 2009-10, their amortization will be recorded as an expense on the Statement of Operations.
- On the revenue side, it is important to consider the treatment of capital grants that are used for TCA.

Implication for Tangible Capital Assets (TCA) con't

- In the current standard, boards are required to recognize the revenue they receive from the province for capital when the capital is purchased. However, the board must recognize an amortization expense for the capital asset over the life of the asset (ex. 40 years).
- For example, assume a board receives a capital grant of $4M to build a school that has a useful life of 40 years. Under the current standard, the following would be recorded:

	Year 1	Year 2	…	Year 40
Revenue: Capital Grants ($)	4,000,000	0	0	0
Expense: Amortization ($)	-100,000	-100,000	-100,000	-100,000
In-Year surplus/(Deficit) ($)	3,900,000	-100,000	-100,000	-100,000

- This means that the board would have a large in-year surplus in the year the asset is purchased due to the capital contribution, but would have small deficits for the following 39 years as a result of the amortization.

The Solution: Deferred Capital Contributions (DCC)

- If boards report their capital as per the previous illustration, the financial statements would not provide a meaningful indication of the usage of revenues and expenses, i.e., this would not be a good way to measure if boards are balancing their budgets and operations.

- The proposed approach to address the above is to introduce a deferral concept through an account called deferred capital contributions (DCC).

- A DCC account is used to record capital contributions. The amount in this account is recognized in revenue in proportion to how the related TCAs are recognized in expenses through amortization.

The Solution: Deferred Capital Contributions (DCC) con't

- Consider the previous example where a board receives a capital grant of $4M to build a school that has a useful life of 40 years. Under the proposed new standard, the board would record the $4M in a DCC account when they have purchased the asset.
- DCC is an account on the Statement of Financial Position, therefore the initial recording of DCC would not impact the Statement of Operations.
- Going forward, as the board starts to recognize amortization expense for the asset, the board would also recognize the capital grant revenue by reducing the DCC account at the same rate as the amortization.
- This means that the capital purchase would not impact the in-year surplus/deficit figure as long as boards spend only the approved amount on capital.

	Year 1	**Year 2**	**…**	**Year 40**
Revenue: Capital Grants ($)	100,000	100,000	100,000	100,000
Expense: Amortization ($)	-100,000	-100,000	-100,000	-100,000
In-Year surplus/(Deficit) ($)	0	0	0	0

Key Changes to the Education Act

- The Education Act will be changed effective September 1, 2010 (i.e. the 2010-11 reporting cycle).
- The changes will be:
    1. Updating budgeting requirements to align with provincial accounting standards;
    2. Improving ability to manage grants separately from cash-flow;
    3. Establishing new financial accountability controls based on financial results; and
    4. Establishing new provisions related to multi-year deficit management strategies and recovery plans.

1. Updating budgeting requirements to align with provincial accounting standards

- The Ministry is amending legislation to update the budget requirements, currently on a modified cash basis, to the provincial accounting standards, which are on an accrual basis.
- Certain terms are no longer relevant and must be replaced with a new term. Other terms require definition in the Act for the first time.

Old Terminology	New Terminology
1. Expenditures	1. Expenses
2. Money	2. Amounts
3. Reserve fund	3.1 Deferred revenue
	3.2 Restricted accumulated surplus
4. n/a	4. Operating revenue
5. n/a	5. Accumulated surplus
6. n/a	6. Accumulated deficit
7. n/a	7. In-year surplus
8. n/a	8. In-year deficit

1. Updating budgeting requirements to align with provincial accounting standards (con't)

- **Expenditures** was changed to **expenses**
  - This is because **expenditures** means the cash that was spent whereas **expenses** refers to the costs accrued, and this may not equal cash spent.

- **Money** was changed to **amounts**
  - Similarly, to provide a distinction between cash spent and costs accrued.

- **Reserve funds** were changed to:
  - **Restricted accumulated surplus** for internally restricted amounts.
  - **Deferred revenue** for externally restricted amounts, consistent with PSAB definition.

1. Updating budgeting requirements to align with provincial accounting standards (con't)

- **Operating revenue** will be used in the definition of compliance.
  - It will include operating grants (revenues).

- **Accumulated surplus/deficit** is defined as the total of a board's current and prior in-year surpluses/deficits.

- **In-year surplus** is the amount by which a board's revenues exceed its expenses in that fiscal year.

- **In-year deficit** is the amount by which a board's expenses exceed its revenues in that fiscal year.

2. Improving ability to manage grants separately from cash-flow

- The Ministry is amending legislation so that school board grant entitlements will be independent from the timing of cash payments.

- Currently, under the Education Act, if a board receives a grant entitlement, the amount payable in cash will flow in the immediate future.

- Grants going forward will mirror a board's expense requirements under the new accounting standards, which might be different than a board's cash requirement.

- One example of where differences may occur relate to non-cash expenses, such as employee future benefits, where costs might be recognized now, but the cash will not be required for many years.

3. Establishing new financial accountability controls based on financial results

- Since reserves will no longer be used in PSAB (standard PS 1200), a new financial control will be put in place for boards' budgeting purposes.

- The Ministry is amending legislation to place a limit on the use of operating reserves or reserve funds (to be called accumulated surplus in the future).

- Boards currently have unrestricted use of reserves; however, using reserves obscures a board's actual financial health.
  - Adding to reserves means a board had an in-year surplus.
  - Using reserves means a board had an in-year deficit.

3. Establishing new financial accountability controls based on financial results (con't)

- A board will be deemed to have a balanced budget if:

  its expenses do not exceed its revenues for the fiscal year by an amount greater than the lesser of:

  1) 1% of the board's **operating revenue** for the school board fiscal year
  2) the board's **accumulated surplus** for the immediately preceding fiscal year

- This is often called the '1% provision'.
- It is the new section 231 in the Education Act.

3. Establishing new financial accountability controls based on financial results (con't)

- The board's deficit may be greater than the criteria above if the board has approval from the Minister.

- The Minister will consider the following in deciding to grant approval:
  - Whether the in-year deficit is structural or one-time in nature.
  - Whether the board has enough accumulated surplus to cover two years worth of in-year deficits.
  - The extent to which the in-year deficit is the result of circumstances beyond the board's control.

3. Establishing new financial accountability controls based on financial results (con't)

- The boards' accumulated surplus will be segmented into three parts:

1. Available for compliance
   - This represents the portion of the accumulated surplus that may be applied to the '1% provision'.
   - Includes prior in-year surpluses.

2. Available for compliance – internally restricted
   - Similar to above, this is the portion of the accumulated surplus that may be applied to the '1% provision', and it is made up of prior in-year surpluses.
   - The distinction is that it has been internally restricted, similar to what would have been previously known as a reserve (ex. snow removal).

3. Unavailable for compliance by regulation
   - This represents the portion of the accumulated surplus that is not available to be applied to the '1% provision'.
   - These amounts would be excluded by regulation, and would be dependent on policy decisions.

4. Establish new provisions related to multi-year deficit management strategies and recovery plans

- The Ministry is amending legislation to permit multi-year deficit management strategies and recovery plans, triggered if:
  - spending is unsustainable;
  - an unplanned deficit occurs; or
  - a deficit is forecast in excess of defined tolerances or approvals.

- Currently, boards are required to approve a balanced budget each year under the Education Act. Legislation is silent on deficits that become apparent at other times (e.g. at Revised Estimates or at Financial Statements).

- A new section has been introduced that gives the Minister the power to trigger a recovery plan:
  - If the board's financial statements show the board had an in-year deficit contrary to section 231, or an accumulated deficit, or;
  - If at any point the Minister has reasonable grounds to believe that the board's financial statements will show that the board will have a deficit contrary to the new section 231, or an accumulated deficit.

4. Establish new provisions related to multi-year deficit management strategies and recovery plans (con't)

- The board would be required to submit a recovery plan within a specified time period. The Minister could approve or change the plan as necessary to address the deficit.

- The board would be required to comply with the recovery plan until the board eliminated its in-year and accumulated deficits.

- The Ministry will propose regulations that address timelines. Options under consideration include criteria to fully address the deficits in less than four fiscal years, e.g.
  - Phase 1 – reduce the in-year deficit to less than 1% of operating revenue
  - Phase 2 – the board should balance in-year
  - Phase 3 – the board shall have eliminated its accumulated deficit

Financial reporting model changes

2010-11 Estimates:

- Boards will be submitting their 2010-11 budget in June 2010.
- This is the first time budgeting will be on the new compliance model.
- This means that budgeting will be on an accrual basis. Previously, non-cash items like amortization were excluded from the compliance calculation.
- To complement the compliance calculation, the boards will be using the new reporting model which includes DCC (deferred capital contributions). Calculation of opening DCC balances will be required.
- Since this is the first time boards will not be expensing their capital, boards will be required to prepare capital budgets.