Financial Reporting Guidance:

Social Housing Transfer to Local Housing Corporations

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R. T. Correll, CA
KPMG – North York

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The transfer of social housing units to municipal service managers as proposed under the provisions of Bill 128 (the Social Housing Reform Act, 2000) gives rise to several financial reporting issues. The financial reporting issues flowing from Bill 128 to be addressed are:

- What is the status for financial reporting purposes of Local Housing Corporations (LHCs) proposed under provisions of Bill 128, and what guidance can be provided in determining the status of Municipal Non-Profit Housing Corporations (MNPs)?
- What are the financial reporting issues arising from the transfer of assets, liabilities, rights and obligations to the LHCs?
- What guidance can be given as to how the Service Manager (SM) should account for its investment in the LHC?

This guideline is technical in nature and has been prepared primarily for the use of municipal and LHC finance professionals and their auditors. All references to Bill 128 throughout this document are based on the First Reading version of the proposed legislation. The information and recommendations provided are based on the facts and assumptions indicated. Municipal and LHC finance professionals and their auditors should consider the applicability of these facts and assumptions to their situation. Should the final legislation or the facts and assumptions of an individual situation differ, the conclusions and recommendations might change.

Background

The Ministry of Municipal Affairs and Housing (MMAH) has mandated that municipalities prepare their financial statements according to the Public Sector Accounting Board (PSAB) recommendations of the CICA effective with the reporting of their 2000 fiscal year financial results. In choosing to mandate PSAB, the Ministry has endorsed the application of Generally Accepted Accounting Principles (GAAP) in the preparation of financial statements. GAAP is generally recognized in Canada as applying accounting principles promulgated by the Canadian Institute of Chartered Accountants (CICA). The CICA establishes accounting principles through a consultative process involving professional accountants from industry, the public sector and the public accounting profession. The Public Sector Accounting Handbook (PSA Handbook), which communicates the recommendations of the PSAB, forms the generally accepted accounting principles applicable to the preparation of financial statements for all levels of government in Canada. GAAP for commercial and non-profit organizations is documented in the CICA Handbook.

Ontario municipalities will prepare their GAAP based financial statements in accordance with the PSA Handbook. Frequently, municipalities own and control local boards and other organizations. The PSA Handbook includes recommendations requiring municipalities preparing financial statements to consolidate organizations they own or control when preparing summary financial statements. Many of these same organizations prepare their own financial statements in order to meet statutory or accountability requirements. As part of this process, decisions need to be made as to the nature of these organizations and the appropriate accounting recommendations to be applied. To assist readers, references will be provided to the recommendations of the PSA Handbook section and paragraph (i.e. PSA 1300.04), the CICA Handbook (i.e. CICA 4200.10) and the legislation {i.e. Bill 128 24(2)}.

Bill 128, as proposed, provides for the formation of LHCs organized under the provisions of the Ontario Business Corporations Act with a SM as the sole shareholder. It is expected that the Province will transfer assets and liabilities relating to the social housing program to these LHCs on January 1, 2001. The consideration paid by the SM's or LHCs for these assets will consist of the assumption of related liabilities including mortgages. Transfer orders prepared in accordance with Part IV of the Bill will define the scope of the transfers. This guideline has been prepared with the understanding that the transfer orders will not include a transfer of the debenture obligations of the Ontario Housing Corporation (OHC).

Summary of Conclusions

Issue #1: Determining the Accounting Model

Conclusions:

- **Status of LHCs:** ***LHCs are Government Not-For-Profit Organizations for financial reporting purposes. Accordingly, they should apply the CICA accounting recommendations for not-for-profit organizations in maintaining their accounts and preparing their financial statements.***

- ***Status of MNPs: Municipal financial statement preparers will need to examine the structure of any existing municipal not-for-profit housing corporations that are part of their reporting entity in a similar manner to determine their status. It is expected that application of these tests to the individual circumstances of these organizations will bring preparers to the conclusion that many of these organizations would be considered Government Not-For-Profit Organizations.***

Issue #2: Accounting for the Transfer by the LHC

Conclusion: ***The LHC acquiring the assets and liabilities should account for the transfer at the book values of the assets and liabilities at the time of transfer from the OHC.***

Issue #3: Accounting by the SM/DSSAB for its investment in the LHC

Conclusion: ***Assuming that there have been no fundamental changes to the LHC in the intervening period from incorporation to the date that the SM or DSSAB is preparing its own financial statements, the SM or DSSAB should consolidate the LHC line by line on a uniform basis of accounting after eliminating inter-governmental unit transactions and balances.***

Appendix A to this document provides example financial statement disclosures.

Appendix B provides a glossary of terms.

Supporting Detailed Analysis

Issue #1: What is the status for financial reporting purposes of Local Housing Corporations (LHCs) proposed under provisions of Bill 128, and what guidance can be provided in determining the status of Municipal Non-Profit Housing Corporations (MNPs)?

As proposed, Bill 128 proposes that upon incorporation, the sole shareholder of the LHC will be its SM {Bill 128 22(7)}. As structured, it is expected that LHCs will be part of the SM's reporting entity as they are owned by it and accountable to the SM in the administration of their financial affairs and resources. The structure as proposed meets the tests in PSA 1300.04. Once an organization is determined to be a part of a government's (or in this case the SM's) reporting entity, a further determination must be made as to the type of government unit the LHC represents. This determination is for the purpose of establishing how the government unit is to be accounted for by the SM and how the government unit itself is to keep its accounts.

The PSA Handbook provides guidance to assist in the categorization of organizations within the government reporting entity. Excluding the government itself, the types of organizations that may exist within its reporting entity are:

- Government business enterprises;
- Government business-type enterprises;
- Government not-for-profit organizations, and,
- Other government organizations.

Definitions are provided in the PSA Handbook for the first three types of government organizations. Other government organizations are simply those which do not qualify under one of the first three categories.

The proposed legislation and draft articles of incorporation were reviewed in an effort to provide guidance as to the appropriate categorization of an LHC. This categorization is important as it determines the accounting principles to be followed by the LHC in maintaining its own accounts. The chart below presents the CICA requirements, summarized from PSA 2500.04.

Type	**Requirements to be met**
Government Business Enterprise	A government organization that has all of the following characteristics: i) It is a separate legal organization with the power to contract in its own name and that can sue and be sued; ii) It has been delegated the financial and operational authority to carry on a business; iii) It sells goods and services to individuals and organizations as its principal activity; and, iv) It can, in the normal course of operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.
Government Business Type Enterprise	A government organization that has all of the following characteristics: i) It is a separate legal organization with the power to contract in its own name and that can sue and be sued; ii) It has been delegated the financial and operational authority to carry on a business; iii) It sells goods and services to individuals and organizations as its principal activity.
Government Not-For-Profit Organization	**A government organization that meets the definition of a not-for-profit organization in the CICA Handbook and which has counterparts outside the public sector. CICA 4400.02 defines not-for-profit organizations as entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.**

The conclusion reached was that LHCs should not be categorized as Government Business Enterprises for several reasons. The conduct of the social housing program as mandated by the proposed legislation contains restrictions and duties that do not give LHCs the freedom to conduct the program as a business. It is not expected that LHCs will be self-sustaining as required by the definition given above. As well, the conclusion that LHCs do not conduct a business would eliminate them from catagorization as Government Business-type Organizations.

Next, the definition of a Not-For-Profit organization was reviewed in relation to LHCs. The proposed legislation and draft articles of incorporation restrict LHCs to the provision, operation and maintenance of housing accommodation, and the delivery of specific programs for the purpose of providing rent-geared-to-income assistance and accommodation for persons having special needs. The LHC is accountable to the SM for program delivery under specific sections of the proposed legislation. Although incorporated with share capital, significant restrictions exist within the legislation on share transfers that would diminish its public sector ownership. Finally, LHCs have counterparts in private non-profit housing providers. Our analysis concludes classification as a Government Not-For-Profit, is the most appropriate status for LHCs.

The organizational structure of local government varies from community to community in Ontario. This structure has been evolving for in excess of 150 years. In some communities all services are conducted under the direct authority of the local council. Other communities have chosen to delegate certain functions to local boards or not-for-profit corporations. The by-laws and governance model of these boards and not-for-profit organizations is not uniform.

The analysis provided in this guideline could be conducted with reasonable certainty in respect of the LHCs being created. However, due to the local variations in the structure of existing not-for-profits, an analysis could not be completed with the same degree of certainty for these organizations. Municipalities or DSSABs with existing MNPs should work with their professional advisors to conduct a similar analysis to determine the nature of the organizations within their reporting entity. It is expected that application of the tests outlined in the CICA Handbook will mean that most non-profit housing entities will report applying the recommendations for non-profit organizations.

Conclusions:

- **Status of LHCs:** ***LHCs are Government Not-For-Profit Organizations for financial reporting purposes.***

- **Status of MNPs:** ***Municipal financial statement preparers will need to examine the structure of any existing municipal not-for-profit housing corporations that are part of their reporting entity in a similar manner to determine their status. It is expected that application of these tests to the individual circumstances of these organizations will bring preparers to the conclusion that many of these organizations would be considered Government Not-For-Profit Organizations.***

Implications:

LHCs and other Government Not-For-Profit Organizations should apply the CICA Handbook Not-For-Profit Accounting Recommendations in maintaining their accounts and in preparing their financial statements.

In applying the Not-For-Profit Accounting Recommendations, LHCs are encouraged to adopt the deferral method of accounting for contributions and to report funds on a combined basis. Appendix A of CICA 4400 provides example financial statements. Situation 1 which applies the deferral method and does not report using fund accounting should be used. In the future if the LHC acquires other organizations, consolidation of any controlled entities is encouraged. CICA 4450 provides recommendations with respect to reporting on controlled and related entities.

Issue #2: What are the financial reporting issues arising from the transfer of assets, liabilities, rights and obligations to the LHCs?

The legislation, contemplates a transfer of assets, liabilities, rights and obligations relating to the social housing program to LHCs following their incorporation. In consideration for this transfer LHCs will assume related liabilities including mortgages and employee future benefit obligations.

The key accounting and financial reporting questions to be addressed arising from these transactions are:

i. What value should the LHC attribute to the assets and liabilities transferred?
ii. How should the liability for debenture payments be recorded?
iii. How should mortgage liabilities be recorded?

Consideration was given to the relationship between the parties to the transfer. Guidance with respect to related party transactions is provided for Not-For-Profit Organizations in CICA 4460. However, the guidance provided does not deal with issues of measurement (CICA 4460.01), clearly at the heart of this question. Seeking guidance on the measurement issue we are left to turn to the related party recommendations applicable to for profit organizations (CICA 3840).

Paragraph 3840.10 provides useful background to the issue at hand:

> *In a historical cost, transaction based accounting model, transactions are generally recognized at the amount of cash or cash equivalents paid or received or at the fair value ascribed to them when they took place. It is generally presumed that a transaction amount arrived at by parties dealing at arm's length represents the fair value of the items exchanged. Conversely, as related parties do not deal at arm's length, a transaction between related parties cannot be presumed to have been entered into at "fair value".*

Bill 128 enables the transfers of assets and related debt. The process leading to the transfer does not involve negotiation between the transferor and the many transfer recipients. The evidence leads to a conclusion that the parties are related for purposes of the transaction as the legislation is evidence of influence over the transfer recipient. Application of the guidance within the Related Party Transactions section of the CICA Handbook is appropriate to the circumstances at hand.

CICA 3840.09 recommends "a related party transaction should be measured at the carrying amount, except as specified in paragraphs 3840.18 and 3840.26". Our assessment is that neither of the exception references are applicable to the circumstances of these proposed transactions for the reasons set out below.

CICA 3840.18 recommends that related party transactions representing the culmination of the earnings process should be measured at the exchange amount when they are in the normal course of operations. The significant transactions contemplated in the draft legislation are clearly not within the normal course of operations.

CICA 3840.26 recommends that related party transactions representing the culmination of the earnings process, not in the normal course of operations, should be measured at the exchange amount if both of the following criteria are met:

i) the change in the ownership interests in the item transferred or the benefit of a service provided is substantive; and,

ii) the exchange amount is supported by independent evidence.

Our assessment is that the second test is not met. The exchange amount, being the assumption of related liabilities has not been determined relative to the appraised or current market value of the related properties. In completing this transfer, the OHC has sought to devolve properties in the service areas of the SMs and to transfer related liabilities only to the extent which the liabilities are specific to the properties.

As the exceptions set out in CICA 3840.18 and 3840.26 are not met, our conclusion is that the transfer should be measured at the carrying (book) amount. Recording the transfer at the carrying amount effectively results in a "book to book" transfer. The LHC will assume the book values of the OHC for the respective assets and liabilities transferred to it. It is expected that the book value of the assets transferred will exceed the liabilities. CICA 3840.17 guides accounting for this residual amount. "When a related party transaction is measured at carrying amount, any difference between the carrying amounts of the items exchanged, together with any tax amounts related to the item transferred, is a contribution of capital to, or a distribution of equity of the enterprise."

Recording the transfer at book value has the benefit of ensuring that the recording basis is similar with other not-for-profit housing that the service manager may have constructed or administers directly. Values used for financial reporting will align more readily with values used for program administration. "Book to book" accounting has been applied in other transfers of assets both between levels of government and in accounting for combinations of not-for-profit organizations in Canada.

Conclusion:

Our research leads us to conclude that the LHC acquiring the assets and liabilities should account for the transfer at the book values of the assets and liabilities at the time of transfer from the OHC.

Implications:

In order to implement this recommendation, the OHC will need to provide information to the LHC to assist it in preparing its opening account balances. The information requirements include the following:

i. Book values for land, building and any chattels transferred. The book values would consist both of original costs for the assets transferred together with the accumulated amortization recorded to date on the related property. These values would become the opening values on the LHC accounts.
ii. For mortgage liabilities, the opening value would be the unpaid principal plus accrued interest since the last payment date at the date of transfer.
iii. For earned but unpaid employee benefit obligations (such as attendance credits), the LHC will need to make a determination of the fair value of the obligations assumed as this information may not be readily available from the OHC accounts.
iv. Any residual balance should be reported as contributed surplus in the LHCs accounts.

Issue #3: What guidance can be given as to how the Service Manager (SM) should account for its investment in the LHC?

SMs will in all cases be municipalities or District Social Service Administration Boards (DSSABs). The MMAH has mandated that municipalities and DSSABs prepare their 2000 financial statements in accordance with the PSA Handbook. Upon incorporation, LHCs will have one shareholder, a municipality or DSSAB. As indicated earlier, initially LHCs will be considered Government Not-For-Profit Organizations and will prepare their own accounts according to CICA Handbook recommendations for Not-For-Profit Organizations.

PSA 1300 defines the scope of the reporting entity in terms of the organizations whose financial affairs and resources should be accounted for in a government's financial statements and recommends how to account for the financial affairs of those organizations in the government's financial statements. PSA 1300.07 recommends that "the government reporting entity should comprise the organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature, or local government council, and are owned or controlled by the government." As an LHC is accountable to the local government council of the SM and is owned by the SM, it would be part of the local government reporting entity of the SM. PSA 1300.20 recommends that “government financial statements should consolidate the financial statements of organizations comprising the government reporting entity, except for government business enterprises”. Accordingly, LHCs which are Government Not-For-Profit Organizations would be consolidated into the financial statements of their SM. Section 2500 of the PSA Handbook outlines mechanics for completing this consolidation process.

Conclusion:

Assuming that there have been no fundamental changes to the LHC in the intervening period from incorporation to the date that the SM or DSSAB is preparing its own financial statements, the SM or DSSAB should consolidate the LHC line by line on a uniform basis of accounting after eliminating inter-governmental unit transactions and balances (PS 2500.06).

Implications:

PSA 2500 entitled “Basic Principles of Consolidation” provides guidance to preparers of consolidated financial statements. A summary of some of the key issues relevant to consolidation of LHCs follows.

Conforming balances:

> In order to complete the line by line consolidation, the financial statement preparer will need to conform the financial statements of the LHC (prepared according to CICA Handbook recommendations for Not-For-Profit Organizations) to the recommendations of the PSA Handbook. Conforming the accounting will require the preparer to identify the financial assets and liabilities of the LHC for consolidation on a line by line basis with like balances of other organizations within the local government’s reporting entity. At present, Ontario municipalities do not generally report capital assets in their financial statements. Present standards do not prohibit the reporting of tangible capital assets by local governments, however they must be shown as non-financial assets if local governments choose to report them in their financial statements.

Inter-governmental transactions:

> If balances exist between the LHC and the local government at the reporting date or there have been inter-governmental transactions during the reporting period these must be eliminated in preparing the consolidated accounts so that double counting does not occur. Similarly, if any transfer of assets has occurred within the government reporting entity any unrealized gains or losses arising must be eliminated.

Statements at different dates:

In the event that the LHC and the local government have different fiscal periods, they still must be consolidated. Reference should be made to PSA 2500.19 to 2500.21 for recommendations addressing this issue.

Appendix A: Example Financial Statement Disclosures

In order to assist financial statement preparers, the following case study and example disclosures have been prepared. Financial statement preparers should carefully consider the circumstances of the transfer they are reporting on, refer to the CICA and PSA Handbooks and their professional advisors in determining disclosures and presentations for their own purposes.

Facts of the example situation:

On January 1, 2001 the OHC transfers the following assets and liabilities to an LHC incorporated on the same date. All of the shares in the LHC are owned by a municipality or DSSAB:

Assets:		
	Land	$ 2,500,000
	Buildings	10,000,000
	Equipment	50,000
		12,550,000
	Less: accumulated amortization	1,550,000
	Net book value	11,000,000
Liabilities:		
	Mortgages	3,000,000
	Employee future benefits	75,000
	Total	3,075,000

Given a presumption that Bill 128, The Social Housing Reform Act, 2000 is enacted and the transfer takes place on January 1, 2001 with the facts as outlined above, the following example disclosures have been prepared:

Reporting by the LHC (Fiscal 2001):

Note 1: Incorporation and Transfer Agreement

On January 1, 2001 the Example Local Housing Corporation (Corporation) was established under the provisions of the Ontario Business Corporations Act. Upon incorporation XXX common shares were issued to the (name of Municipality/DSSAB) for nominal consideration.

As part of its local services realignment program, transfers of social housing units owned by the Ontario Housing Corporation (OHC) have been made in accordance with transfer orders prepared under authority of The Social Housing Reform Act, 2000. Under the provisions of such a transfer order, this Corporation was the recipient on January 1, 2001 of assets, liabilities, rights and obligations previously owned by the OHC and located in the Municipality of Example. Effective on the date of the transfer, the Corporation is responsible for the management and operation of the housing projects transferred and is bound by the requirements set out in the legislation.

The transfer was recorded on the Corporation's accounts at book value and represents substantially all of the social housing assets, liabilities, rights and obligations of the OHC located within the geographic area of (describe). Summary details are as set out below:

Land, buildings and equipment	$11,000,000
Mortgages and other obligations	3,075,000
Contributed surplus recorded	$ 7,925,000

Note: The above represents summary note disclosure for financial statement reporting purposes only. The LHC should prepare an opening balance sheet with supporting account balances from the OHC and record full details of the opening balances in its accounts including the full cost of assets acquired and accumulated amortization balances.

Reporting by the Service Manager (Fiscal 2000):

Note X: Subsequent Event

On (insert date), Bill 128, the Social Housing Reform Act received Royal Asset. Under provisions of this legislation, the Example Local Housing Corporation was established as an Ontario Business Corporation on January 1, 2001 with the (name of municipality or DSSAB) as its sole shareholder. Under provisions of a transfer agreement, the Ontario Housing Corporation transferred social housing program assets located in the (name of municipality or DSSAB) consisting of land, buildings, equipment and related liabilities, rights and obligations. Effective January 1, 2001 the Example Local Housing Corporation is managing and operating these social housing units under the provisions of the legislation and related regulations. The Province is continuing subsidy support of the program in accordance with provisions of the legislation.

Reporting by the Service Manager (Fiscal 2001)

Note X: Incorporation of Local Housing Corporation and Transfer Agreement

As part of the provincial local services realignment program, the municipality acts as service manager for social housing located in the municipality. To facilitate the transfer of social housing units of the Ontario Housing Corporation (OHC) located in the (name of municipality/DSSAB), on January 1, 2001 a Local Housing Corporation (the LHC) was established under the provisions of the Ontario Business Corporations Act with the (name of municipality/DSSAB) as its sole shareholder. Nominal consideration was given for the XXX common shares issued upon incorporation.

Under the provisions of a transfer order prepared under authority of The Social Housing Reform Act, 2000, the LHC was the recipient on January 1, 2001 of assets, liabilities, rights and obligations previously owned by the OHC. Effective on the date of the transfer, the municipality/DSSAB as service manager and the LHC are responsible for the management and operation of the housing projects transferred and are bound by the requirements set out in the legislation

The transfer was recorded at book value and represents substantially all of the assets, liabilities, rights and obligations of the Ontario Housing Corporation located within the geographic area of (describe). Summary details are as set out below:

Land, buildings and equipment	$11,000,000
Mortgages and other obligations	3,075,000
Contributed surplus recorded	$ 7,925,000

These financial statements include the results of operations arising from the acquired social housing operations from the date of their acquisition.

Appendix B: Glossary of Terms

To assist the reader in understanding the various technical terms and references in this document the following definitions and explanations are provided.

Book value: The value recorded in the accounts in respect of an asset or liability generally as determined based on the historic cost accounting model.

Book-to-Book: The use of values of assets and liabilities in the organization receiving those assets and liabilities based on the values recorded in the books of the organization transferring those assets and liabilities.

CICA: Canadian Institute of Chartered Accountants.

CICA Handbook: A manual containing recommendations of the CICA's Accounting Standards Board in respect to matters of accounting practice.

DSSAB: District Social Service Administration Board.

GAAP: Generally Accepted Accounting Principles. GAAP is defined by the CICA as "the term used to describe the basis on which financial statements are normally prepared". "GAAP encompasses not only specific rules, practices and procedures relating to particular circumstances but also broad principles and conventions of general application." The CICA and PSA Handbooks are important references sources for information regarding GAAP in Canada. Refer to CICA 1000.60 for a summary of the points of reference for GAAP in Canada.

Government-Not-For-Profit Organization: A government not-for-profit organization as defined by the PSA Handbook is a government organization that meets the definition of a not-for-profit organization in the CICA Handbook and which has counterparts outside the public sector. For purposes of this definition, the public sector refers to federal, provincial, territorial and local governments, government organizations, government partnerships, and school boards.

LHC: Local Housing Corporation, an Ontario Business Corporation created under provisions of Bill 128.

MNP: Municipal Non-Profit Housing Corporation.

Not-For-Profit Organizations: Not-For-Profit Organizations are defined by the CICA Handbook and PSA Handbook as entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

PSAB: Public Sector Accounting Board (Canadian Institute of Chartered Accountants)

PSA Handbook: A manual containing recommendations of the CICA's Public Sector Accounting Standards Board in respect of accounting practice applicable to public sector organizations.

Reporting Entity: The recommendations of the PSA Handbook provide that "the government reporting entity should comprise the organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature, or local government council, and are owned or controlled by the government" (PSA 1300.04).

SM: Service Manager. A service manager may be a municipality or DSSAB under provisions of Bill 128.