NEWSLETTER NO. 29

INTER-GOVERNMENTAL AND INTERNAL TRANSFERS

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In the late 1990s, the Ontario Provincial Government transferred a variety of tangible capital assets to municipalities. These included most of the Provincial highway system, all assisted or low-rental housing projects of the former Ontario Housing Corporation, homes for the aged, some hospitals, water filtration and sewage plants that had been managed by the Ministry of the Environment or the Ontario Clean Water Agency, and so forth. Similarly, the Federal Government transferred the country's major airports to local government, or to a local "airport authority."

There was no financial consideration or accounting involved with respect to these assets as assets per se, though there certainly was with respect to the on-going management and to the operations and program responsibilities associated with them. There was no formal asset accounting for the transfer of the assets. Any and all accounting for both parties was on the current account side or the Revenue Fund.

In addition to this example, there are also cases of "service migration" where responsibility for a service, and its associated assets, is transferred from one local government to another, often from a lower tier municipality to a county or regional government (e.g. transit in the Regions of Durham and York).

Finally, assets owned by a municipality are sometimes transferred between departments or agencies, boards and commissions of the municipality. Currently, this happens with no formal accounting of the transfer.

The move to tangible capital asset accounting requires such transfers to be recorded. A major issue now for both the transferor and the transferee is on what basis should such assets be valued as of the date of transfer – at historical cost, net book value, or at fair market value? This newsletter will look at the issues and considerations for each type of transfer.

Note that these transfers can be exchange transactions, where there is a quid pro quo that is either cash or other tangible capital assets, or non-exchange transactions, where the assets are effectively given away, as the transferor does not directly receive a benefit that is economic in exchange in return.

An exchange transfer is analogous to a commercial sale/purchase or a barter. For the **transferor**, the consideration received for the asset, whether cash or fair market value of assets received in return, constitutes the proceeds of disposition, and the difference between that value and net book value of the asset being transferred out as of the date of transfer will constitute a loss or gain on the disposition of that asset as the case may be, in accordance with PS 1000.60. For the **receiver**, the value of the asset will be the consideration paid, such as the cash paid and/or the net book value of all tangible capital assets offered in consideration. PS 1000.60 also allows the use of fair market value for assets given in return, which would then also give rise to a gain or loss on disposition of those assets offered up.

The rest of this newsletter will focus on non-exchange transfers, which have traditionally been more common practice in the public sector.

Please note that, currently, PS 3410 of the Public Sector Accounting Handbook on government transfers "*does not deal with: …..non-monetary transfers, such as transfers of natural resources, rights, investments and **physical assets***." (PS3410.02 (f)) The latest re-exposure draft of a revised Section PS 3410 does cover the transfer of tangible capital assets in non-exchange transactions, but this re-exposure draft is still under review and not GAAP for the public sector. In the meantime, the reader is referred to PS 1150 for guidance as to an appropriate source of generally accepted accounting principles (GAAP).

Public Sector Accounting Handbook, PS 3150 – Tangible Capital Assets

"*Governments may receive contributions of tangible capital assets. The cost of a contributed asset is considered equal to its fair value at the date of contribution. Fair value of a contributed tangible capital asset may be estimated using market or appraisal values. In unusual circumstances, where an estimate of fair value cannot be made, the tangible capital asset would be recognized at nominal value.*" (PS3150.14)

Inter-governmental Asset Transfers in the hands of the Recipient

These are typically assets that have been transferred by a more senior level of government to a municipality, or vice versa. For past transfers, these assets do not currently appear on the accounts of the municipality. Starting in 2009, they must be accounted for and included, as must all future transfers of tangible capital assets, if any.

PS 3150.14 instructs us to value the assets at fair value if possible, as of the date of contribution or the date that title, ownership and legal responsibility and liability is transferred,. There is no waiver or special treatment specified for inter-governmental transfers. This approach values the asset at what it would have been worth, **as is,** as of the date of transfer, so that the resulting calculation of amortization over time closely represents the consumption of that asset in the hands of the municipality. PS 1000.60 deals with the measurement of costs and applies to situations of asset transfers. PS 1000.60 states that:

> *Measurement is the process of determining the amount at which an item is recognized in the financial statements. There are a number of bases on which an amount can be measured. Government financial statements are, however, prepared primarily using the historical cost basis of measurement, whereby transactions and events are recognized in financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place. Other bases of measurement are also used, but only in limited circumstances.*

This applies to all assets transferred from another government, both retroactively and going forward. Please note that the value of a non-exchange transfer received by a recipient should be recognized as revenue in the year the asset is received, as this is a transfer.

It is now Provincial policy and practice to record every tangible capital asset transfer at fair market value, and to account for it like any other commercial transaction, including being paid in full for the asset. Thus any future transfers will be exchange transactions, and accounted for accordingly.

Inter-governmental Asset Transfers in the hands of the Donor

If you transfer out the assets before January 1, 2009, they are a non-issue, as they will not be part of your starting asset inventories, and not be included in your tangible capital asset reporting. If you will still be paying off debt or other financing on such assets, unfortunately, that will be a financing issue and accounted for as such, and is not an asset accounting one. For TCA accounting purposes, they are gone and not even history, if before last January 1st.

Starting January 1, 2009, the situation changes dramatically. You will be required to account for such transfers, but how you account for them will depend on how the transfer is structured. If there is some financial consideration paid, or other assets exchanged as in barter, this will be for whatever amount you and the other party agree to as a fair exchange. This is an exchange transaction, as discussed earlier.

As a non-exchange transaction, there is no consideration paid in return for the assets by the recipient. You are simply rationalizing responsibilities, and relocating the appropriate assets. In your accounts, excluding transfers to a government business enterprise, this will trigger an expenditure (or expense) equal to the net book value of the transferred assets which is a charge against current year's operations. This again is consistent with measurement of the transaction per PS 1000.60, even though no consideration was received in return. The diminution of your TCAs is still measurable, and the reduction in value is real. This has been addressed more specifically in the afore-mentioned re-exposure draft.

Internal Transfers

Within your municipality, assets sometimes get transferred between departments and/or agencies, boards and commissions. Again, do you transfer them on the books at gross and net book value, or at fair value as of the date of transfer?

In terms of the consolidated accounts of your municipality, there has been no deemed disposition, as the asset was, and still is, on your books. There has simply been an agreement between colleagues to transfer the asset to another organizational unit within the municipality. This is very definitely a non-arm's length transaction, as it is within the "family".

For these transfers, it is recommended that you use the historical cost of the asset and the accumulated amortization currently on the books, and simply transfer those values in your accounts over to the receiving organizational unit. This is probably a good example where determining fair value as of the date of transfer would not be worth the additional effort required in terms of "enhanced" financial reporting. It would give rise to a gain or loss on disposition of an asset that was not actually disposed of by the municipality, anyway. PS 2500.18 requires you to exclude such gains or losses from your consolidated statements.

The one exception to this would be where the one party is a separate legal entity, such as an incorporated municipal housing company or a government business enterprise, and there is no consideration being offered in return for the asset being transferred. The transferred asset would be recorded by each party to the transfer as discussed in the previous two sections. However any unrealized gain or loss between a disposal at net book value and a donation at fair market value may well be eliminated in the consolidated financial statements for the municipality (PS 3070.32).

In general, this is a different type of transfer, with a different type of approach to valuation.

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Up to now, we have looked at various aspects of developing your asset inventories, from a more high-level view. Our next newsletter will digress somewhat, and go over what you should ideally have in place for December 31, 2008. This will be like a laundry list of what information should be available for financial reporting in 2009, plus what systems, procedures and policies you will find helpful to have for on-going asset accounting going forward from January 1, 2009.

For more information and resources regarding tangible capital asset management, go to PSAB/Asset Management or contact:

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NOTE: This Newsletter is published to assist you with your implementation of tangible capital asset accounting and with related matters. The Public Sector Accounting Handbook is the only authoritative primary source on matters relating to GAAP, and you should consult with your auditor to resolve specific issues that you may have.