NEWSLETTER NO. 45

BUDGETING FOR TANGIBLE CAPITAL ASSETS (3) - DONATED AND TRANSFERRED ASSETS

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We have been looking at how you may want to budget for certain types of tangible capital assets. Now let us look at TCAs that are donations or transfers, from an outsider to your own organization, or vice versa.

If you transfer an asset from Department A to Department B within your organization, there will simply be the accounting entry:

Debit Tangible Capital Assets – Dept B	$X	
Credit Tangible Capital Assets – Dept A		$X

- along with an analogous entry to move over the accumulated amortization for the asset.

Sub-dividers will often build internal roads, possibly watermains and sewers, and then give them over to the municipality gratis as part of the subdivision agreement, or will provide land for a park or a school. Assets may be transferred between governments, such as when the Region takes over local transit services, or builds sidewalks on Regional roads that are given to the local municipalities. A private individual may donate or bequeath a heritage property to the municipality.

How will you budget for these, if you can?

Current Practice

This is easy. Since tangible capital assets are not recorded at all, there is nothing to budget for, unless you are building something that will be transferred, such as the afore-mentioned sidewalks. The budget would be for the total road construction, including sidewalks, and expensed in the year the work is paid for. The only concern is any potential impact on the operating budget, which may be very significant, such as taking over or giving up transit operations.

Accounting for the donation or transfer of tangible capital assets is currently a non-issue, if there is no financial consideration in return. If there is, then it is a sale/purchase.

2009 and Future Years

PS 3150.14 requires that the contribution or transfer of a tangible capital asset be recorded at fair value as of the date of contribution, i.e. accounted for. Since the amount could be significant, or even material, such as a take-over of transit or of a home for the aged, it would be prudent to budget for it.

The accounting aspect of this situation was dealt with at some length in Newsletter #29 – Intergovernmental and Internal Transfers. How do you budget for them in an accrual budget format?

Transfers to Outside-Parties – 2009 and forward

This is somewhat easier, as you are generally in control over what you give away or transfer to an outside party, such as the sidewalks. In Waterloo Region, if you are planning to rebuild a regional road, you know you will be turning the sidewalks over to the local municipality. Similarly, if you know that it is being planned to consolidate transit next July 1st, then you know that your bus depot and the vehicles will be transferred to the Region.

These can and should be included in the budget for next year, as expenditures in the operating budget. The assets are in your accounts at net book value, and you will be receiving nothing in return. The resulting reduction in the total value of your assets caused by the transfer is a cost to the municipality, and is therefore an expense:

Debit Loss on disposition of assets due to transfer	$X	
Debit Accumulated Amortization (of the assets transferred)	$Y	
Credit Tangible Capital Assets (transferred)		$(X+Y)

Like amortization expense, this is a non-cash transaction. If cash is involved, then the amount $X is the difference between the net book value and the consideration received. It is your option as to whether to budget for and to finance this net cost or not. In the case of the transit, you probably may not want to. In the case of the sidewalks, you may, as this will be an out-of-pocket expense, when it happens.

Note that these are transfers of physical assets, so that Section PS 3140 on Government Transfers does not currently apply, per Paragraph PS 3410.02 (f), with respect to the accounting for them. However, this will likely change in the not too distant future with the anticipated adoption of the second revised Exposure Draft on Government Transfers. See the section on this at the end of this Newsletter.

Transfers from Outside Parties – 2009 and forward

When it comes to budgeting for transfers from outside parties, will you know what you are about to receive? The bus fleets and the homes for the aged, you may, as those arrangements do not usually happen overnight. Transfers from developers and bequests and other private donations are less predictable.

This is probably less critical, as these are more like windfalls that increase your equity or accumulated surplus, without requiring any financial outlay or incurring a financial liability with respect to the acquisition of the asset itself. If there is some financial consideration involved, then the transfer should be budgeted for in your capital investment plan or capital budget, and sources of financing identified. This would be more like a purchase. The difference between fair value and the consideration paid will be included in the Statement of Operations as "gain or loss on transfer of tangible capital asset."

As with financing from outside parties discussed in the previous newsletter, transfers from outside parties end up increasing the Accumulated Surplus account, or "Municipal Equity", of the municipality. The fair value of the asset is the equivalent value of the donation or "other revenue" that can be recorded in the Statement of Operations, and which will flow through to Accumulated Surplus as "profit" at year-end, as there was no offsetting expense.

Re-Exposure Draft of PS 3410 – Government Transfers

A second Re-Exposure Draft on Government Transfers is being developed by the Public Sector Accounting Board of the Canadian Institute of Chartered accountants, with release planned for March 2009. Once approved by PSAB, Section PS3410 on Government Transfers will then definitely apply to tangible capital assets (paragraph 3410.04). PS 3410.07 does recognize that all government transfer programs or initiatives are discretionary, and wholly under the direction of the transferring government, although negotiation regarding transfer terms does occur. Please note that references cited here refer to the first Re-Exposure Draft issued in April 2007 and not the current Handbook version.

Initial recognition by both parties is specified as follows;

> PS 3410.09 – *A government transfer should be recognized by a transferring government as an expense in the period the transfer is authorized as described in paragraph PS 3410.28 and eligibility criteria, if any, have been met by the recipient.*
>
> PS 3410.15 – *A government transfer should be recognized by a recipient government as revenue in the period the transfer is authorized as described in paragraph PS 3410.28 and eligibility criteria, if any, have been met by the recipient, except when and to the extent that the transfer stipulations create a liability in accordance with LIABILITIES, Section PS3200.*

However, note the different accounting treatment for each party to the transfer:

> PS 3410.13 – *The transfer of a tangible capital asset is recognized as an expense by a transferring government* ***at the net book value*** *of the tangible capital asset transferred.*
>
> PS 3410.20 – *The transfer of a tangible capital asset would be recognized by a recipient government in the amount of the assets* ***fair value.*** *For a transfer of a tangible capital asset recognized as a liability in accordance with paragraph PS 3410.15 transfer stipulations would require revenue recognition as the asset is used to provide goods or services to third parties over the specified period up to a maximum of its useful life.*

Note the difference in valuation of the transfer price for each party for financial reporting purposes. As before, (per PS 3410.56(b))

PS 3410.39 states *"Financial statements should disclose major kinds of transfers made or received."*

Another interesting difference is that recognition is now required when **agreement is reached**, **not when the transfer actually happens.** Thus in the case of the sidewalks, you may budget, finance, build and account for them next year, because you likely do not have an agreement with the local municipality this year to give them a specific sidewalk next year. The donation will be an outcome of how you decide to utilize your road building budget next year.

However, if you agree with the Region this year to transfer over your bus system next year, then the transfer is to be recognized by both parties this year, as effectively it is a done deal in this fiscal period, you just need time to be able to make it happen. This is no different from buying a car, where the sale is completed and a matter of record once the financing is in place, whereas you may not take delivery for several weeks or more. Note PS 3410.28:

> *"A determination that a transfer is authorized requires evidence at the financial statement date of:*
> *(a) the authority to enter into a transaction, which is conveyed through approved legislation, regulations or by-laws; and*
> *(b) the exercise of authority under legislation, regulations or by-laws in place."*

It may be hard to budget for something like the transit transfer, unless discussions and negotiations are extending over a couple of years, and you expect the agreement to be finalized next year.

The Re-Exposure Draft quoted in this section can be found at www.cica.ca. Then click on Standards/Public Sector Accounting/Documents for Comment/Government Transfers to see the complete document.

Summary

The accounting treatment of donations and transfers will be quite different starting in 2009 and going forward. It would be prudent to budget for these, to the extent that they are known or likely.

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Our next newsletter look at how you may want to budget for disposals and write-downs of tangible capital assets in the years to come, and how that may be impacted by PS3150..

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

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