PSAB/Asset Management

NEWSLETTER NO. 24

JOINT USE AGREEMENTS

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During the Fall Workshops, questions were raised about joint-use agreements, cost-sharing, and other situations where two or more parties have an interest in a tangible capital asset.

Blessed are they who have avoided such entanglements, but if you haven't been able to, how do they get treated under PS 3150?

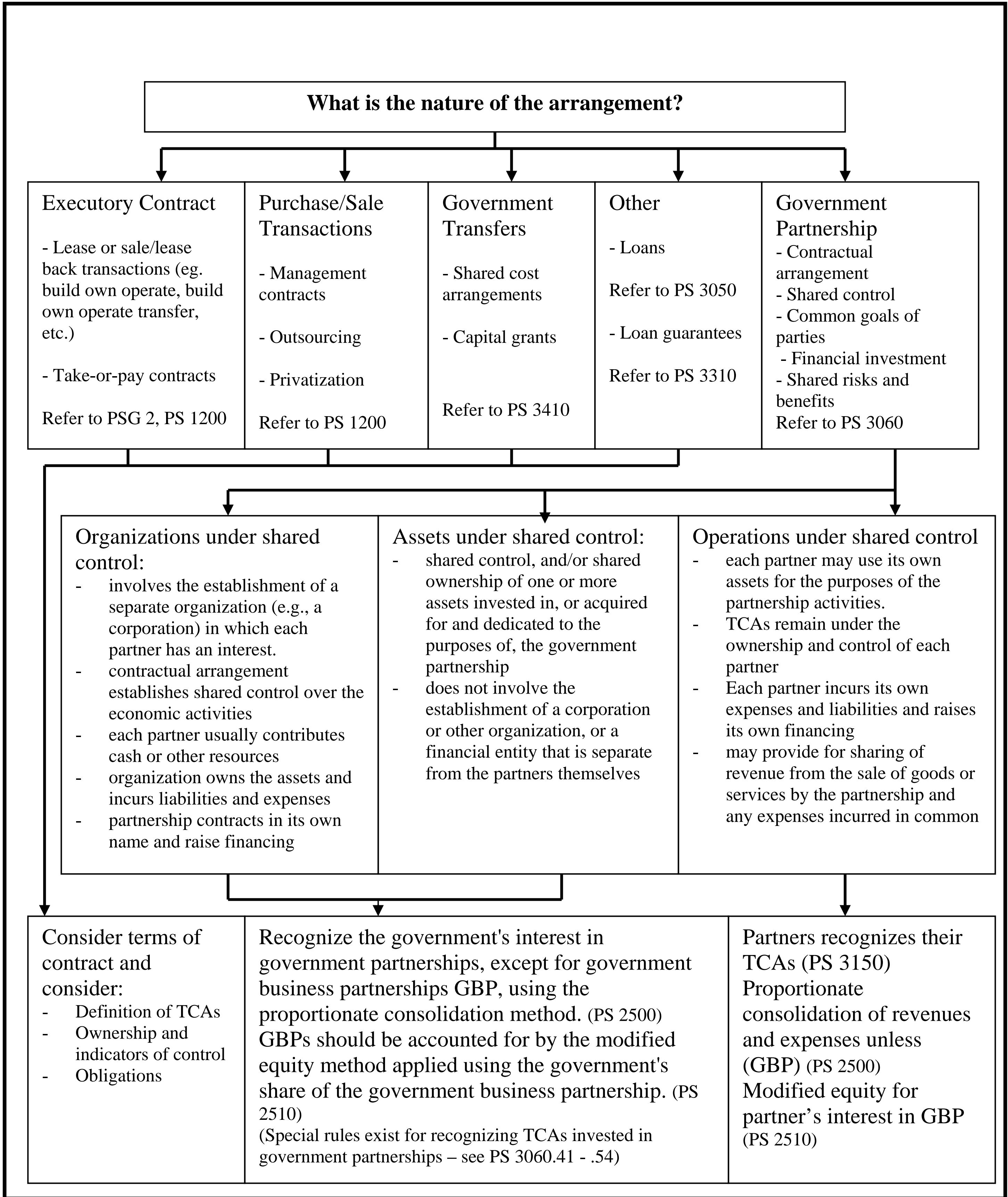
Each Agreement is Unique

The TCA accounting requirements for each agreement will reflect the unique characteristics of the agreement. For this reason, there can be no hard and fast advice provided on how to treat assets governed by agreements. The specific facts and characteristics of the agreements will dictate the appropriate accounting standards to be used in accounting for and reporting the associated transactions.

For example, the agreement may be as simple as a Joint Use Agreement between a City and School Board that provides for access to recreational facilities (sports fields, arenas) and school facilities (gymnasiums, class rooms). The tangible capital assets are owned and controlled by the respective parties to the agreement.

It could be a boundary road agreement that determines the sharing of the cost of ongoing maintenance and construction or improvement. In most cases, ownership and control of the boundary road is unaffected and each municipality would continue to account for its proportionate share of the road and any betterments as a tangible capital asset.

However not all arrangements are as clear cut. The first question that must be answered is "What is the nature of the arrangement?" The following decision tree may help in your analysis.


What is the nature of the arrangement?
Executory Contract
- Lease or sale/lease back transactions (eg. build own operate, build own operate transfer, etc.)
- Take-or-pay contracts
Refer to PSG 2, PS 1200
Purchase/Sale Transactions
- Management contracts
- Outsourcing
- Privatization
Refer to PS 1200
Government Transfers
- Shared cost arrangements
- Capital grants
Refer to PS 3410
Other
- Loans
Refer to PS 3050
- Loan guarantees
Refer to PS 3310
Government Partnership
- Contractual arrangement
- Shared control
- Common goals of parties
- Financial investment
- Shared risks and benefits
Refer to PS 3060
Organizations under shared control:
- involves the establishment of a separate organization (e.g., a corporation) in which each partner has an interest.
- contractual arrangement establishes shared control over the economic activities
- each partner usually contributes cash or other resources
- organization owns the assets and incurs liabilities and expenses
- partnership contracts in its own name and raise financing
Assets under shared control:
- shared control, and/or shared ownership of one or more assets invested in, or acquired for and dedicated to the purposes of, the government partnership
- does not involve the establishment of a corporation or other organization, or a financial entity that is separate from the partners themselves
Operations under shared control
- each partner may use its own assets for the purposes of the partnership activities.
- TCAs remain under the ownership and control of each partner
- Each partner incurs its own expenses and liabilities and raises its own financing
- may provide for sharing of revenue from the sale of goods or services by the partnership and any expenses incurred in common
Consider terms of contract and consider:
- Definition of TCAs
- Ownership and indicators of control
- Obligations
Recognize the government's interest in government partnerships, except for government business partnerships GBP, using the proportionate consolidation method. (PS 2500) GBPs should be accounted for by the modified equity method applied using the government's share of the government business partnership. (PS 2510)
(Special rules exist for recognizing TCAs invested in government partnerships – see PS 3060.41 - .54)
Partners recognizes their TCAs (PS 3150) Proportionate consolidation of revenues and expenses unless (GBP) (PS 2500) Modified equity for partner's interest in GBP (PS 2510)

Example:

Two neighbouring municipalities decide that it would be advantageous to share a community centre that would be able to provide services to residents of both municipalities.

Scenario 1

The municipalities have entered into a agreement that provides for establishment of clearly defined common goals, financial investment of each municipality, the process for making decisions related to the financial and operating policies on an ongoing basis of the community centre and the sharing of significant risks and benefits associated with the operations.
Both municipalities jointly enter into a contract with a third party to design, build and operate the community centre. Ownership of the community centre is transferred to the municipalities as cotenants[1] upon completion of construction and each municipality is responsible for providing its share of the financing.

This type of arrangement is a government partnership involving shared control of a tangible capital asset. Each partner would account for its proportionate share of the partnership asset, any revenues and expenses and liabilities.

Scenario 2

Municipality A contracts with a third party to design, build, transfer and operate the community centre. Municipality A enters into an agreement with Municipality B that provides its residents have access to the community centre on a cost sharing basis. The agreement stipulates the cost sharing formula based on operating expense and cost of capital.

In this case, there is no government partnership. Municipality A would recognize the tangible capital asset in its books. It would account for the money received from Municipality B as a government transfer. It would recognize any obligations it has under the contract with the third party contractor.

Scenario 3

Municipality A and B form a joint board to build and operate the community centre. The joint board is authorized to contract with a third party to design, build, and transfer and operate the community centre. Each municipality agrees to provide the financing for its proportionate share of the cost of construction and share of operating deficits. The municipalities have entered into a agreement that provides for establishment of clearly defined common goals, financial investment of each municipality, the process for making decisions related to the

[1] **cotenant** n. one who holds an interest in real property together with one or more others.

financial and operating policies on an ongoing basis of the community centre and the sharing of significant risks and benefits associated with the operations.

In this case, there is a government partnership in the form of a government organization under shared control. Each government accounts for its interest on a proportionate consolidation basis.

Scenario 4

Municipality A owns and operates a community centre. Municipality B, due to recent growth in the area and Municipality A, due to the existence of excess capacity of the community centre, are interested in entering into an agreement to share the community centre. The municipalities have entered into an agreement that provides for establishment of clearly defined common goals, financial investment of each municipality, the process for making decisions related to the financial and operating policies on an ongoing basis and the sharing of significant risks and benefits associated with the operations. Municipality A continues to own the community centre.

There is a government partnership in the form of operations under shared control. When Municipality A invested the tangible capital asset in a government partnership it would report Municipality B's share of the community centre as disposal. Municipality A would calculate gains and losses based on the fair value less the net carrying amount of the asset. Any loss that occurs should be recognized at the time of the initial investment in the statement of operations of Municipality A. Any gain that occurs would be treated as a deferred gain at the time of the initial investment only to the extent of the interests of Municipality B. The deferred gain would not be amortized and only recognized as revenue when the assets are distributed to the partners upon dissolution or sold. Municipality A would recognize the net carrying amount of its interest in the community centre in its statement of financial position.

Similarly, Municipality B would report its proportionate share of the fair value of the tangible capital asset as a purchase. In particular, Municipality B would treat that amount as an increase in the tangible capital assets reported in the statement of financial position in accordance with PS 1200 and PS 3150.

Government Business Partnership

A government business partnership meets all of the characteristics of a government partnership set out in PS 3060.06 as well as the characteristics as set out in PS 3060.07 below:

(a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;

(b) it has been delegated the financial and operational authority to carry on business;

(c) it sells goods and services to individuals and organizations other than the partners as its principal activity; and

(d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources other than the partners.

Government business partnerships should be accounted for by the modified equity method[2] applied using the government's share of the government business partnership. Accounting for tangible capital assets invested in a government partnership for which the government receives in exchange an interest in the government business partnership is similar to the treatment for a government partnership, except that a deferred gain related to the tangible capital assets invested is amortized to net operating results in a rational and systematic manner over the life of the invested assets. Refer to PS 3060.47 for the appropriate accounting treatment.

An example of a government business partnership might be a municipal hydro utility that provides power to a number of municipalities. There may be scope for additional examples if municipalities create corporations for various purposes under section 203 of the Municipal Act and corresponding regulation (O. Reg. 599/06) and they meet the definitions of a government partnership and have the characteristics of a government business partnership.

As Always: Talk to Your Auditor

We have become aware of a number of approaches to accounting for tangible capital assets that have agreements associated with them. As always, it is important to speak to your auditor about the approach that you wish to adopt with regard to reporting on assets covered by agreements. It is important that all of the assets are accounted for, and accounted for only once, in a way that is based on the relevant standards discussed above.

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Our next newsletter will take a look at works of art and historical treasures and discuss how to deal with historical buildings and villages.

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

[2] Modified equity is a basis of accounting for a government's interest in government business partnerships whereby the equity method of accounting is modified only to the extent that the government business partnership's accounting principles are not adjusted to conform with those of the government.

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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.