

18.2 Other Contractual Obligations

Policy Statement

It is the policy of the Province of Nova Scotia to record contractual obligations in accordance with generally accepted accounting principles for the public sector.

Definitions

CONTRACTUAL OBLIGATION¹

A contractual obligation exists when a legally binding contract or agreement has been signed with an arm's length third party outside the government reporting entity (GRE). Contractual obligations are:

- obligations of a government to others that will become liabilities in the future when the terms of those contracts or agreements are met;
- distinct from liabilities as there has been no past transaction or event obligating the government to a future sacrifice of economic benefits at the financial statement date;
- distinct from contingent liabilities as there is no uncertainty related to the contractual obligation's existence

GOVERNMENT REPORTING ENTITY (GRE)

The government reporting entity (GRE) is comprised of the organizations that are controlled by the government, which include the Province's departments and public service units (General Revenue Fund), government business enterprises (GBEs), other governmental units (GUs), and the Province's proportionate share of government partnership arrangements (GPAs). Trusts administered by the Province are excluded from the reporting entity. A full listing of entities reported within the GRE can be found in Schedule 10 of the Province's Public Accounts.

Policy Objective

The objective of this policy is to ensure that contractual obligations are properly, consistently, and accurately identified and disclosed in the Public Accounts of the Province of Nova Scotia. Disclosing a government's contractual obligations is useful

¹ For purposes of this Corporate Administrative Policy manual, contractual obligations include operating leases. Guidance on how to distinguish between operating and finance leases can be found in Chapter 18.1 Operating and Finance Leases.

because it provides information about the nature and extent to which a government's resources are already committed to meet its obligations.

Application

This policy applies to all of the Province's departments, public service units, agencies, boards, and commissions contained in the General Revenue Fund (hereinafter referred to as "departments").

Organizations outside of the General Revenue Fund but within the GRE are encouraged to adopt a policy that allows for the accurate and consistent reporting of contractual obligations to external parties. This policy should be in compliance with the entity's generally accepted accounting framework. It is recognized that many entities may already have an appropriate policy in place. These organizations are responsible for disclosing their contractual obligations to the Government Accounting Division as part of the year-end consolidation reporting requirements.

Policy Directives

A contractual obligation is identified and disclosed based on the accounting standards and guidelines contained within the Public Sector Accounting (PSA) Handbook. In applying this policy, departments identify all contractual obligations under their area of responsibility.

Information about a government's contractual obligations that are significant in relation to its current financial position or future operations should be disclosed in notes or schedules to the financial statements and should include descriptions of their nature and extent and the timing of the related expenditures. As a result, departments are to prepare and submit to the Government Accounting Division each year-end a detailed listing of contractual obligations (in the format prescribed by Government Accounting). This schedule is to contain a description of the agreement, the counterparty, the contract start and end dates, and the contract value at the current and prior year-end dates. It also lists the expected payments in each of the next five years and in five-year time bands thereafter.

Contractual obligations that would be disclosed include, but are not limited to, those that:

- a. involve a high degree of speculative risk;
- b. result in expenditures that are abnormal in relation to the financial position or usual business operations of the Province; and

- c. will govern the level of a certain type of expenditure for a considerable period into the future.

To ensure the completeness and accuracy of the schedule, departments must also complete, sign, and submit a contractual obligations checklist, as developed by Government Accounting.

Policy Guidelines

CONTRACTUAL OBLIGATIONS

Contractual obligations should be reported when:

1. A legally binding contract or agreement has been signed with an external third party.
 - a. Determining whether a contract or agreement is legally binding may require consultation with legal counsel (e.g., Memorandum of Understanding).
 - b. A signed agreement is needed – Orders-in-Council or media releases alone do not create contractual obligations.
 - c. Contracts with entities controlled by the Province are not reported as these would be eliminated upon consolidation.
2. They represent obligations that will become liabilities in the future when the terms of those contracts or agreements are met.
 - a. To be a future liability, the contract must:
 - i. Result in the sacrifice of future economic benefits
 - ii. Leave the Province with little to no discretion to avoid settlement
 - b. Only obligations that will be liabilities are reported. Items that will become assets (e.g., loans receivable) are not reported as contractual obligations.
3. They warrant disclosure. Contractual obligations should be disclosed when they:
 - a. Have an appropriate basis for measurement and can be reasonably estimated
 - b. Are significant in relation to the Province's current financial position or future operations. Significant contracts include, but are not limited to, those that:
 - i. involve a high degree of speculative risk (e.g., contract term linked to the price of oil or other high-fluctuating index)
 - ii. require expenditures that are abnormal in relation to the financial position or usual business operations
 - iii. will govern the level of a certain type of expenditure for a considerable period into the future (i.e., long-term contracts)

- iv. represent commitments that exceed a certain reporting threshold (as determined and communicated by Government Accounting)

A decision tree is included in Appendix 18-A to assist in the application of these guidelines.

ENSURING COMPLETENESS, EXISTENCE, AND ACCURACY

At the end of each fiscal year, departments must provide a summary of their contractual obligations in the format prescribed by Government Accounting and provided to departments during the planning phase of the year-end audit. To ensure the completeness, existence, and accuracy of their reported contractual obligations, departments should, among other things:

- Communicate regularly with program staff to determine if any new agreements have been signed and to assess the nature, duration, and value of these contracts
- Search for potential contractual obligations by periodically reviewing and following up on media releases and Orders-in-Council (OICs)
- Report all years of a multi-year agreement
- Disclose only the provincial share of obligations under a cost-sharing agreement
- Remove contracts from their schedule when they have expired or have been otherwise terminated

PROGRAM FUNDING

Contractual obligations do not include a government's obligations related to ongoing programs such as health, welfare, and education. In these cases, a government does not have a contractual obligation to others and maintains complete discretion as to whether to change the level or quality of its programs or the delivery of these programs. However, once a government enters into a contract or agreement, a contractual obligation exists and a certain degree of discretion to avoid the obligation is lost. As a result, signed multi-year funding agreements qualify as contractual obligations and need to be reported as such.

CONTRACT CLAUSES

Often, contracts contain clauses that provide the government with opportunities to rescind the contract should some specified event occur. Examples include, but are not limited to:

- Clauses which indicate that payments are subject to appropriations
- Clauses which require the recipient to continually meet eligibility criteria
- Cancellation clauses

Contracts that contain these types of clauses must be disclosed unless there is clear evidence that a contract will indeed be rescinded. Departments would apply professional judgment in determining what constitutes clear evidence and, in some cases, legal rulings may be needed. Rescinded contracts would continue to be disclosed until all final payments are made (e.g., cancellation penalties, etc.).

SHARED COST AGREEMENTS²

Governments frequently enter into cost-sharing agreements with other governments or external parties. Typically, these agreements specify some maximum amount that will be paid out under the cost-sharing agreement. Funds are then disbursed to suppliers, service providers, grant recipients, or other payees under secondary agreements (e.g., a construction contract).

On the date the cost-sharing agreement is signed, it may be difficult to assess the timing and amount of future outflows. Nonetheless, the nature and the maximum exposure of the agreement should be reported. This disclosure does not have to appear in the contractual obligations schedule, but should be noted at the bottom of the schedule.

When greater certainty around the timing and amount is known, expected outflows should be reported in the contractual obligations schedule. This may happen, for example, when secondary contracts are signed with external parties.

Accountability

DEPARTMENTS

Departmental Financial Services Divisions/Corporate Service Units are responsible for:

- implementing and complying with this policy
- tracking all contracts and determining if they require disclosure under the terms of this policy
- maintaining current and accurate contract information
- responding to Government Accounting inquiries regarding contractual obligations
- preparing their annual contractual obligations schedule
- providing the Office of the Auditor General with the evidence requested for the audit of contractual obligations

² For definition, see Budgeting and Financial Management Manual, Chapter 22.3 Government Transfers.

GOVERNMENT ACCOUNTING DIVISION

The Government Accounting Division within the Department of Finance is responsible for:

- distributing the contractual obligations schedule to departments at year-end
- communicating the contractual obligations reporting threshold to departments at year-end
- compiling the list of total contractual obligations for the General Revenue Fund
- compiling the list of total contractual obligations for the consolidated government reporting entity by reference to the financial statements and worksheet packages of the governmental units, government business enterprises, and government partnership arrangements
- liaising with departments and the Office of the Auditor General, as needed
- monitoring the application of this policy
- periodically updating this policy in consultation with departments

Monitoring

Departmental Financial Services Divisions/Corporate Service Units are responsible for monitoring the implementation and compliance of this policy. The Department of Finance, Government Accounting Division is responsible for monitoring the application, performance, and effectiveness of this policy.

References

PS 3390 – Contractual Obligations, Public Sector Accounting (PSA) Handbook

Appendices

18-A Contractual Obligations Decision Tree

Enquiries

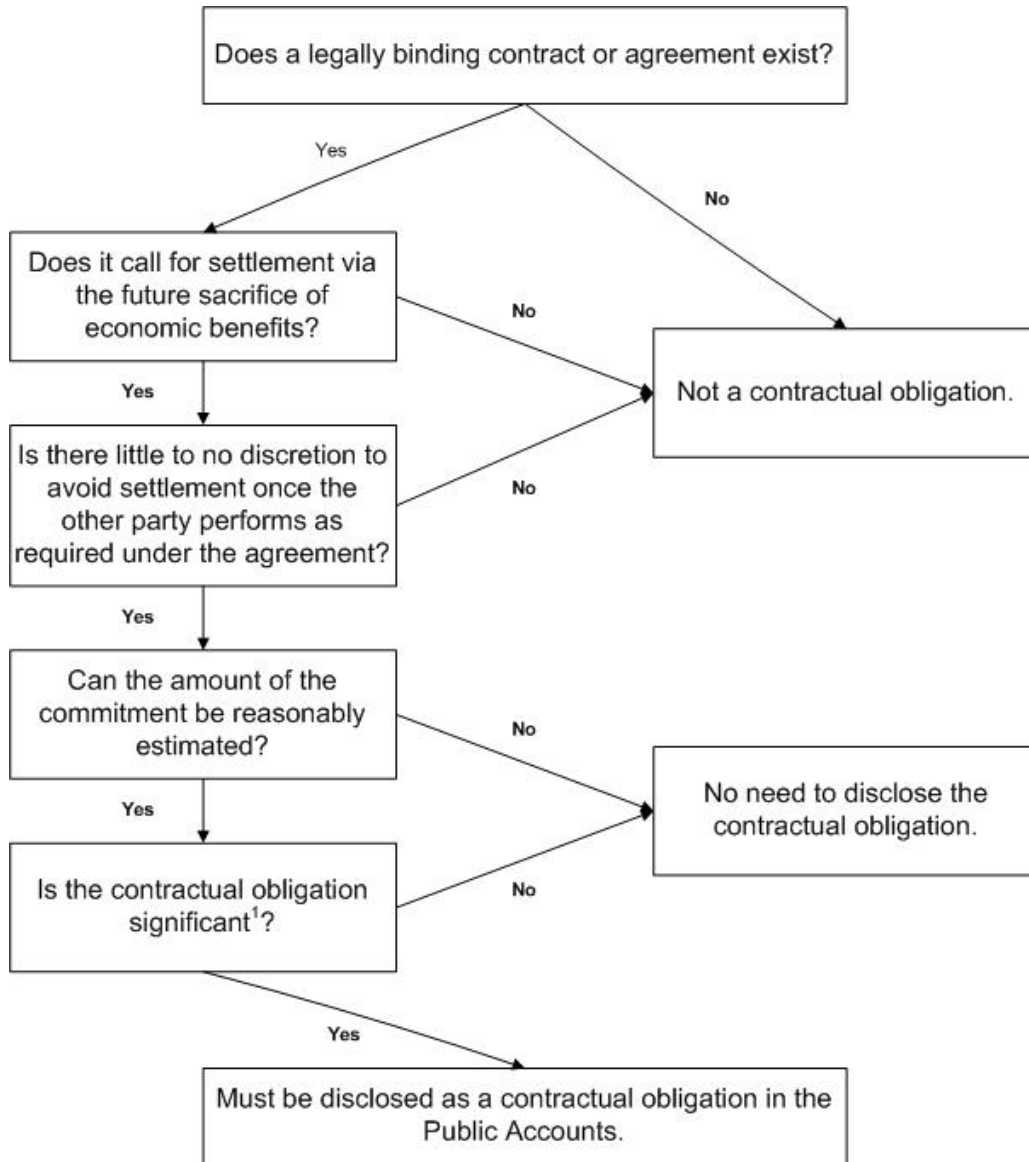
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Appendix 18-A

Contractual Obligations Decision Tree



¹ Significant contractual obligations include but are not limited to those that:

- A) Involve a high degree of speculative risk.
- B) Call for expenditures that are abnormal in relation to the financial position or usual business operations.
- C) Will govern the level of a certain type of expenditure for a considerable period into the future.
- D) Represent commitments that exceed a certain reporting threshold (as determined and communicated by Government Accounting).