

## 18.3 Contractual Rights

### Policy Statement

It is the policy of the Province of Nova Scotia (Province) to account for and report contractual rights in accordance with Canadian public sector accounting standards (PSAS).

### Definitions

#### **CONTRACTUAL RIGHT**

A contractual right exists when a legally binding contract or agreement has been signed with an arm's length third party that, in the future, will result in both an asset and revenue once the terms of the contract or agreement are met.

Contractual rights are:

- distinct from assets as there has been no past transaction or event giving rise to an asset at the financial statement date
- distinct from contingent assets as there is no uncertainty related to the existence of the contractual right

### Policy Objective

The objective of this policy is to ensure that contractual rights are properly, consistently, and accurately identified and disclosed in the Province's consolidated financial statements. Disclosure of contractual rights is useful because it provides an understanding of the economic resources available in the future to meet the Province's obligations or to finance future operations.

### Application

This policy applies to all contractual rights of the Province's departments, agencies, boards, and commissions of the General Revenue Fund (hereinafter referred to as "departments").

Organizations outside of the General Revenue Fund but within the Government Reporting Entity<sup>1</sup> are encouraged to adopt a policy that allows for the accurate and consistent reporting of contractual rights from external parties. This policy should comply with the entity's generally accepted accounting framework. It is recognized

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<sup>1</sup> For definition, see Corporate Administrative Policy Manual #200, Chapter 4.1 Government Reporting Entity.

that many entities may already have an appropriate policy in place. These organizations are responsible for disclosing their contractual rights to the Government Accounting Division as part of the year-end consolidation reporting requirements.

## Policy Directives

A contractual right is identified and disclosed based on the accounting standards and guidelines contained within PSAS. In applying this policy, departments are to identify all contractual rights under their area of responsibility. A contractual right exists when a legally binding contract or agreement has been signed with an arm's length third party. Contractual rights are terms in a contract or agreement that will result in the recording of both an asset and revenue in the future when the terms of those contracts or agreements are met.

Information about a government's contractual rights that are significant in relation to the 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 revenues. As a result, departments must submit annually, in the format prescribed by Government Accounting, a detailed listing of contractual rights. The contractual rights listing should contain a description of the agreement, counterparty, contract start and end dates, and contract value at the current and prior year-end dates. It should also list the expected revenues in each of the next five years and in five-year time bands thereafter.

Contractual rights are governed by contract law and are distinct from certain public sector entity rights, such as the right to tax or the right to license. Such rights are derived from legislation based on constitutional authority or delegated constitutional authority. For examples of the types of contractual rights that would be required for disclosure, see Appendix 18-C.

## Policy Guidelines

### CONTRACTUAL RIGHTS

A contractual right should be reported when:

- I. A legally binding contract or agreement has been signed with an arm's length third party.
  - a. Consultation with legal counsel may be needed to determine whether a contract is legally binding.

- b. A signed agreement is needed – Orders-in-Council alone do not create contractual rights.
  - c. Contracts with entities controlled by the Province are not reported as these would be eliminated upon consolidation.
2. They represent rights that will become assets and revenues in the future when the terms of those contracts or agreements are met.
  - a. To be a future asset/revenue, the contract must:
    - i. Result in future economic benefits
    - ii. The Province can control the economic resource and access to the future economic benefits
  - b. Only rights that will ultimately be recorded as assets and revenues are reported. Items that will become liabilities and expenses are treated as contractual obligations (See Policy 18.2).
3. They warrant disclosure. Contractual rights should be disclosed when they:
  - a. Have an appropriate basis for measurement and can be reasonably estimated
  - b. Are significant in relation to the current financial position or future operations of the Province. Materiality thresholds will be determined annually by Government Accounting.

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

Contractual rights may include, but are not limited to, contractual rights to receive payments under a cost-shared agreement or contractual rights to receive lease payments.

#### **ENSURING COMPLETENESS, EXISTENCE, AND ACCURACY**

At the end of each fiscal year, departments must submit to Government Accounting a summary of their contractual rights. To ensure the completeness, existence, and accuracy of their reported contractual rights, 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 rights 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 rights under a cost-sharing agreement
- Remove contracts from the contractual rights schedule when they have expired or have been otherwise terminated

### **CONTRACT CLAUSES**

Often, government contracts contain clauses that provide the transferring 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

Unless there is clear evidence to suggest that contract clauses will result in non-payment, the contractual right must still be disclosed.

### **COST-SHARING AGREEMENTS**

Governments frequently enter into cost-sharing agreements with other governments or outside parties. Typically, these agreements specify some maximum amount that will be paid out under the cost-sharing agreement over a certain amount of years.

On the date the cost-sharing agreement is signed, it may be difficult to assess the timing and amount of future inflows. Nonetheless, the nature and the expected inflows of the agreement should be reported so long as it can be reasonably measured. However, any future expenses that will need to be incurred in order to benefit from this funding, will not be a contractual obligation, unless a separate external agreement exists and qualifies as a contractual obligation.

### **AGREEMENTS WITH NO END DATE**

If an agreement, contract, or memorandum of understanding (MOU) does not have an end date, it will not be required on a department's disclosure listing.

### **FLOW-THROUGH TRANSACTIONS**

In a situation where an agreement results in a future obligation/expense that will be fully funded by an external source, the disclosure should be consistent with how the transactions will eventually be recorded. If both a revenue and expense will be recognized in the future (i.e., recorded gross), then there should be an item recorded on both the contractual rights schedule and the contractual obligations schedule. On the contrary, if the agreement is a true flow-through transaction (i.e., recorded net) and a revenue or expense will not be recognized in the future, then it should not be part of either disclosure listing.

## Accountability

The process of accounting for and reporting contractual rights is shared among and requires the collaboration of the following divisions:

### **FINANCE AND TREASURY BOARD - FINANCIAL ADVISORY SERVICES (FAS)**

Responsible for:

- complying with this policy
- tracking all contracts/agreements 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 rights
- preparing the contractual rights schedule (as prescribed by Government Accounting)
- providing the Auditor General with the evidence requested for the audit of contractual rights

### **FINANCE AND TREASURY BOARD - GOVERNMENT ACCOUNTING**

Responsible for:

- distributing the contractual rights schedule to FAS groups at year-end
- compiling the full list of contractual rights for the General Revenue Fund
- compiling the contractual rights of the consolidated entity by reference to the financial statements and worksheet packages of the governmental units
- liaising with departments and the Auditor General, as needed
- updating this policy, periodically, in consultation with departments

## Monitoring

FAS groups are responsible for monitoring the implementation and compliance of this policy. The Government Accounting Division is responsible for monitoring the application, performance, and effectiveness of this policy.

## References

Public Sector Accounting (PSA) Handbook, Section PS 3380 – Contractual Rights

## Appendices

18-B Contractual Rights Decision Tree

18-C Contractual Rights Examples

## Enquiries

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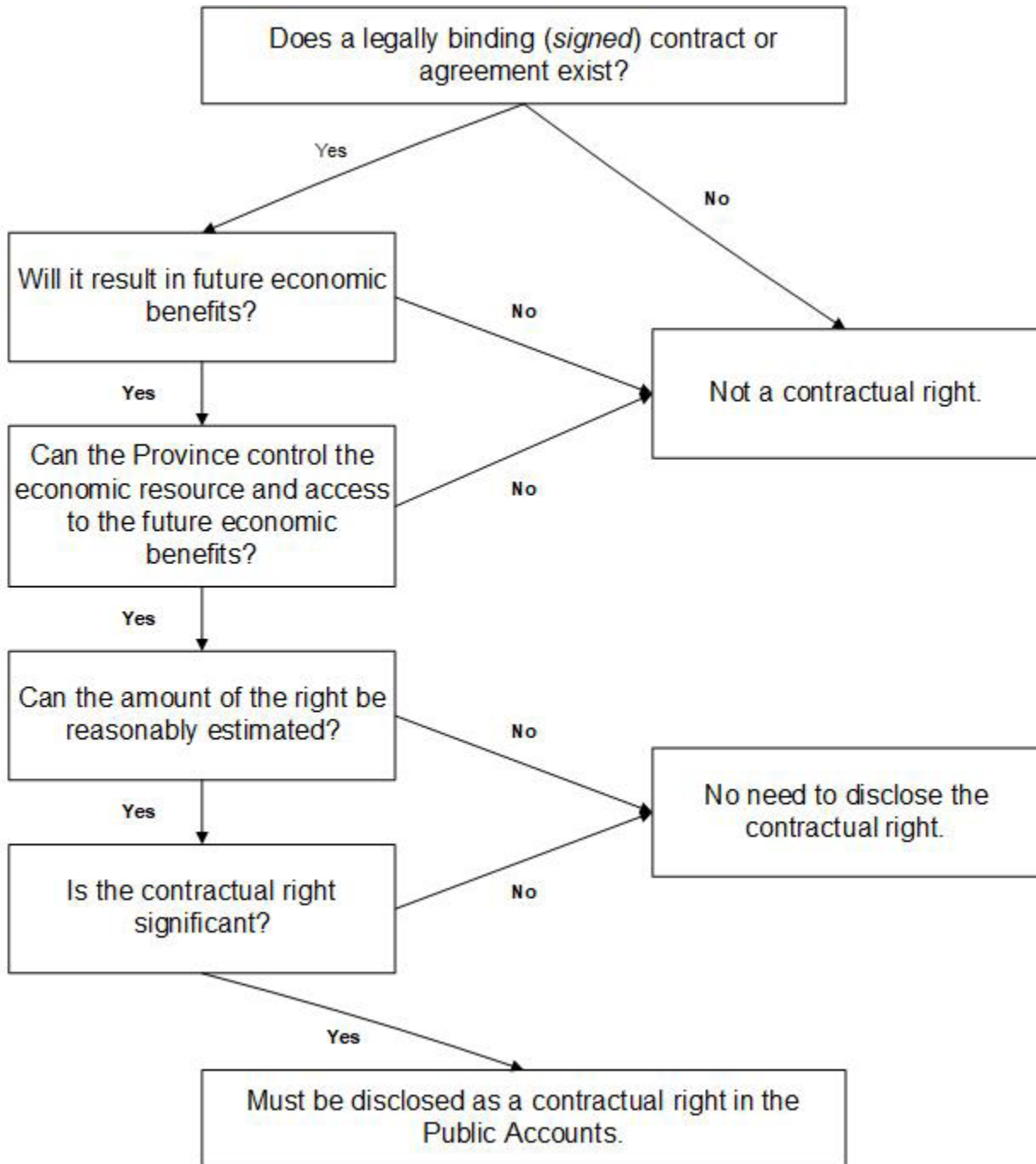
Approved by: **Executive Council**

Administrative update:

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Appendix 18-B

# Contractual Rights Decision Tree



## Appendix 18-C

# Contractual Rights — Examples

### Example 1

#### CONTRACT DETAILS

The Province official signs an agreement on September 1, 2019 that includes a \$5 million commitment of funding over 5 years from the federal government. The funding will be distributed by the federal government once per fiscal year, in equal \$1 million increments. The first payment was received October 1, 2019. There is a clause in the agreement that states that each \$1 million payment is contingent on being approved in that particular year's federal budget.

#### RESULT (AS AT MARCH 31, 2020)

As per the legally binding contract, there should be a contractual right disclosed for the remaining 4 years of funding. That is, \$1 million should be disclosed for fiscal 2020-21 through to fiscal 2023-24. Unless there is clear evidence to suggest that certain contract clauses will result in non-payment, the contractual right must still be disclosed.

### Example 2

#### CONTRACT DETAILS

A news release confirmed that the federal government will be renewing its funding agreement with the Province of Nova Scotia that expires March 31, 2020. As year-end approaches, the details are mostly finalized, \$12 million over 3 years; however, the contract does not “officially” get signed until April 2, 2020.

#### RESULT (AS AT MARCH 31, 2020)

There should not be a contractual right disclosed for March 31, 2020 since the agreement was not officially signed at year-end. This contract will, however, be relevant for the March 31, 2021 disclosure.



### Example 3

#### CONTRACT DETAILS

The Province enters into a cost-sharing agreement with the federal government that sets out an overall amount that will be contributed to approved projects in Nova Scotia over a certain number of years. The funding for these approved projects will be on a 50/50 cost-shared basis. There is no reason to believe that the Province will not take advantage of the entire amount, even though they are only covering 50% of approved projects.

#### RESULT

The Province should ensure that the total contractual right for this agreement is equal to the total amount of remaining funding available from the federal government under the agreement. That is, the total amount that the federal government agreed to fund less the amount the Province has already recorded as revenue thus far.

As for the distribution of those amounts over the disclosed future years (i.e., contractual rights related to 2020-21 vs 2021-22 and so on), the relevant department must use their best estimate. It would be expected that this estimate would take into consideration all of the projects that are being budgeted for.

### Example 4

#### CONTRACT DETAILS

The Province enters into an agreement with the federal government that details certain eligible expenditures that can be fully recovered on a go-forward basis, up to a certain annual maximum. The agreement does not define an end date. As at March 31, 2020, the Province is recording \$15 million worth of contractual obligations that will eventually be recovered under this agreement.

#### RESULT

Since the Province has entered into contractual obligation agreements that will trigger a future recovery under this agreement, a contractual right should be recorded in an amount that mirrors the recorded contractual obligations. Even though there is no end date to the federal agreement, it would be misleading to not include a corresponding contractual right. However, it should be noted that, except for this specific situation, any other agreement without an end date would not be included in the contractual rights disclosure.