

PSAB/Asset Management

NEWSLETTER NO. 27 MUNICIPAL DRAINS

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In Newsletter #23, we took you through a thought-process that you may find helpful for looking at your assets, and determining where they will logically fit in the changed accounting and reporting environments, come 2009. The intent was to give you a decision-making framework so that you can determine whether that doodad is indeed a tangible capital asset, to be accounted for and reported on as such. In the majority of cases, this decision tree will yield a fairly straight-forward answer as to whether something is a tangible capital asset or not.

Unfortunately, you will likely have to address items where the model does not yield a definitive result. You will have to make a judgment call, to include in inventory or to exclude, based on the preponderance of the evidence available. At some point, make sure that your auditor agrees with your call, especially if the value of the asset(s) may be substantial.

In this newsletter, we will apply this decision-making framework to a particular type of asset, namely municipal drains, to demonstrate how to use this approach to deal with the less obvious situations that you may encounter. These drains are probably an ideal example of the importance of applying the definitions related to assets found in the Public Sector Accounting Handbook.

On the Q&A Hotline and in private conversation, the question of how to handle municipal drains has been raised. In enquiring around the Province, the consensus message has been that, while these drains may be a municipal concern and a municipal responsibility, they are not being seen as municipal assets, or at least not significant or material ones. Consulting firms have also commented that their clients are not considering drains as tangible capital assets.

Municipal Drains

What are “municipal drains?” The Ministry of Agriculture, Food and Rural Affairs offers the following definition:

“Physically a municipal drain is simply a drainage system. Most municipal drains are either ditches or closed systems such as pipes or tiles buried in the ground. They can also include

structures such as dykes or berms, pumping stations, buffer strips, grassed waterways, storm sewer detention ponds, culverts and bridges. Even some creeks and small rivers are now considered to be municipal drains. Municipal drains are primarily located in rural agricultural areas of the province.” ([Ministry of Agriculture, Food and Rural Affairs, FACTSHEET #01-059](#)).

This “*includes a drain constructed by any means, including the improvement of a natural watercourse, and includes works necessary to regulate the water table or water level within or on any lands or to regulate the level of the waters of a drain, reservoir, lake or pond, and includes a dam, embankment, wall, protective works or any combination thereof.*” ([Drainage Act, Sec 1](#))

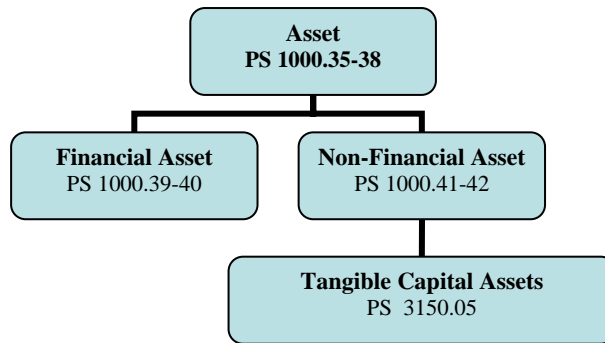
They are created under the authority of the [Drainage Act](#). The Ministry of Agriculture, Food and Rural Affairs identifies three key elements of municipal drains:

1. Landowners submit a prescribed petition requesting the establishment of a municipal drain. If certain criteria are met, the municipality appoints an engineer who prepares a report, identifying the proposed solution to the problem and how the costs will be shared. There are subsequent consultations so that the final result is a communally accepted project.
2. The municipality passes a by-law adopting the engineer’s final report. This is authority to construct the drain, and to assess costs against the interested parties in the ratios outlined in the engineer’s report.
3. Once constructed, a municipal drain becomes part of the municipal infrastructure. The municipality is responsible for repairing and maintaining the municipal drain, and in certain circumstances, may be held liable for damages arising from not doing so satisfactorily.

In many cases, the new drainage works required may cross and be located on private property. The property owner still owns the land. The municipality carries out the work required, and the property owners are assessed the costs involved over a number of years. Current practice is to record the costs of constructing these drains as accounts receivable, recoverable from future assessments, rather than as capital costs. The municipality maintains the drain on an on-going basis, and allocates the costs out to the beneficial parties in the ratios stipulated in the engineer’s report and in the by-law. ([Drainage Act, Section 74](#))

Is a municipal drain a municipal tangible capital asset?

Regardless of whether a Ministry states that a municipal drain is part of the municipal infrastructure, the issue of whether it is a tangible capital asset rests solely on whether it meets three definitions found in PS 1000. Tangible capital assets are a subset of non-financial assets, which in turn are a subset of assets, as shown in the diagram below.



The definitions referred to in the diagram above are produced here for your convenience. The passages are taken from section 1000.

.35 **Assets** are economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.

.36 Assets have three essential characteristics:

- (a) they embody a future benefit that involves a capacity, singly or in combination with other assets, to provide future net cash flows, or to provide goods and services;
- (b) the government can control access to the benefit; and
- (c) the transaction or event giving rise to the government's control of the benefit has already occurred.

.37 An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph. Thus, for example, an item does not qualify as an asset of a government if the item involves:

- (a) no future economic benefit;
- (b) future economic benefit, but the government cannot obtain it; or
- (c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred.

.38 For an asset to be a government's asset, that government must control the future economic benefit associated with the asset to the extent that it can benefit directly from the asset and generally can deny or regulate access to that benefit by others. For example, the direct benefits of education and health care programs accrue to and are controlled by the individuals who are educated or treated and healed. Therefore, the costs of such programs, which are often called "investments", are excluded from being assets of the government.

.42 **Non-financial assets** are acquired, constructed or developed assets that do not normally provide resources to discharge existing liabilities, but instead:

- (a) are normally employed to deliver government services;
- (b) may be consumed in the normal course of operations; and
- (c) are not for sale in the normal course of operations.

.43 **Tangible capital assets** are non-financial assets ¹ having physical substance that:

- (a) are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets;
- (b) have useful economic lives extending beyond an accounting period;
- (c) are to be used on a continuing basis; and
- (d) are not for sale in the ordinary course of operations. (Also found in PS 3150.05)

In applying the definitions of asset, non-financial asset and tangible capital asset to municipal drains, there may be a number of areas where drains might not meet the criteria in the various definitions. For example, given the definition of an asset, a number of questions arise. As noted, assets are "economic resources" of the government from which future economic benefits are expected to be obtained. A future benefit involves a capacity, singly or in combination with other assets, to provide future net cash flows, or to provide goods and services. To be an asset of the government, that government must control the future economic benefit associated with the asset to the extent that it can benefit directly from the asset and generally can deny or regulate access to that benefit by others. It could be argued that this is not the case with regard to municipal drains. In applying the definition of a tangible capital asset other questions arise.

"A tangible capital asset is a non-financial asset (perhaps) having physical substance (yes) that:

1. *is held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets; (services for the beneficial parties, certainly, but not for the municipality per se, except where the municipality is a beneficial party, per the engineer's report)*
2. *has a useful economic life extending beyond an accounting period; (yes)*
3. *is to be used on a continuing basis; (definitely) and*
4. *is not for sale in the ordinary course of operations. (definitely, not marketable)"*

Most of the time, a municipal drain will not meet the criterion in point #1 above. As already noted, it is also possible to question whether there is the requisite degree of control referred to in the definition of an asset in PS 1000.35 or whether it is employed to provide government services as per PS 1000.42.

It should be noted that even if you choose to exclude municipal drains as tangible capital assets, it can still happen that drainage works done under the *Drainage Act* could affect your tangible capital assets. For example, if the pumping capacity of a pumping station is enhanced as part of the drainage works under the Act, this would constitute a betterment of a municipal tangible asset that is directly related to work undertaken under the *Drainage Act*.

Now let us apply the decision tree to municipal drains.

1 DO YOU NOW OWN THE ASSET, OR DO YOU CONTROL IT, OR DERIVE SUBSTANTIAL BENEFITS FROM IT? HAVE DE FACTO OWNERSHIP OF IT, SUCH AS THROUGH A CAPITAL LEASE?

You control it and maintain it on behalf of the collective property owners. You have paid for it, though the property owners will ultimately reimburse you for the construction costs. Yet if property owners can sever their segments, and reclaim the portion of their property that was occupied by the drain, do you really control it, or are you just a custodian or trustee for the beneficial owners? And who benefits from this asset, your municipality, or the property owners abutting the drain?

Although there are mixed signals as to who owns and controls this asset, are the payments or assessments from the beneficial property owners really buying the asset, or is this simply financing or reimbursement to your municipality for a benefit that you are providing to the property owners in return? As stated earlier, if there is no direct benefit to the municipality, then the drain does not really satisfy the definition of a tangible capital asset (PS3150.05(a)(i)), as the property owners are the real beneficiaries. It is really their tangible capital asset, particularly as they have a financial stake in the asset and receive the benefits..

In summary, whether the answer to Question #1 is “yes” or “no” may well have to be answered for each municipal drain, based on location and on each by-law Agreement. If the answer to question 1 is “no,” then the process terminates. To continue the process of moving through the decision tree, we will assume that question 1 is answered with a “yes.”

2 IS IT TANGIBLE, HAVE PHYSICAL FORM, WILL BE USED FOR 2 OR MORE YEARS BEYOND THIS ACCOUNTING PERIOD, AND IS NOT FOR SALE IN THE NORMAL COURSE OF BUSINESS?

Obviously yes.

3 IS IT A WORK OF ART, HISTORICAL TREASURE, NATURAL RESOURCE?

Obviously no, to all three charges.

4 WHAT DID THE ASSET COST AT TIME OF ACQUISITION OR TRANSFER?

Your municipality constructed the drain, so that you will hopefully have the actual construction costs, plus all directly attributable costs. These are what you will have been allocating out to the appropriate property owners, in whole or apportioned. The costs are documented in an engineer's report.

5 IS HISTORICAL COST DATA AVAILABLE FOR THE ASSET?

Is it available? If so, great. If not, you may be able to work this one back from the assessments charged to property owners, if the drain is still being paid off by them.

6 IS THIS AN EXISTING ASSET OR A NEW ACQUISITION?

If existing, then go to Point #7. If it is a new construction, then go back to #4 and determine actual cost or fair market value, as the case may be.

7 CAN YOU ESTIMATE THE ORIGINAL COST FOR THIS ASSET FOR PURPOSES OF THE INITIAL ASSET INVENTORY?

Can you determine its cost at time of acquisition using discounted cost of reproduction new, discounted replacement cost new, or a discounted appraisal value? As suggested, can you estimate the original cost from the engineer's report. **Caution:** will this last method be very time-consuming, so that the time and effort would be better spent dealing with more significant assets?

One can argue that this is a land improvement, so that there would be no accumulated amortization from date of acquisition to December 31, 2008. Over time, it may become overgrown and naturally fill in, which would be abandonment, by definition. If maintained, a drain or ditch does not deteriorate, and will continue to provide the same benefits as before.

8 IS THE VALUE OF THE ASSET WORTH MORE THAN THE VALUE OF THE FUTURE BENEFIT STREAM FROM THE ASSET?

First ask, what is the value of the future benefit stream to your municipality, as opposed to the property owners? If the benefits are really minimal or non-existent, then perhaps a substantial or total write-down will be appropriate, if you are recording the drains.

9 IS IT ABOVE YOUR CAPITALIZATION THRESHOLD?

If not, expense it, or include it in an asset pool. Note that you would use an asset pool only if your municipal drains in total represent a significant amount that should be reported and amortized.

10 HAVE YOU DOCUMENTED THE ASSET, AND CREATED AN AUDIT FILE FOR IT?

If you have, then you are finished accounting for the asset. It is now part of your asset inventory, and has been documented for audit and follow-up purposes.

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Our next newsletter will take a look at what tools you may need or want to acquire to handle this accounting change. Vendors and consultants will cheerfully sell you software packages and help you implement them. Is some of this overkill? The newsletter will not recommend specific software solutions, but try to help you determine what you may need to handle the initial inventory, and to prepare for on-going asset accounting.

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.