PSAB/Asset Management

NEWSLETTER NO. 54

CONSOLIDATED STATEMENT OF CHANGE IN NET DEBT - what is it?

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The next statement in your "new format" Annual Financial Report will be the Consolidated Statement of Change in Net Debt. This is the title in Handbook Section PS 1200, though if a municipality's total financial assets are greater in value than total liabilities, it would be more appropriate to call this the Consolidated Statement of Net Financial Assets. Since Irgendwo has net financial assets, it calls its statement the Statement of Change in Net Financial Assets, with corresponding descriptors in the body of the statement, rather than use the net debt terminology.

Again, please note that this material is prepared to illustrate how the standards of the handbook might be implemented, with respect to an actual financial report. The presentation is not intended to indicate preferred formats, or to prescribe standardized note disclosure, as variations in format and wording will be required to meet the requirements of differing circumstances. The current and new reports do not purport to be best practice or best of breed, just a good example of what you are working towards.

This statement is primarily designed to explain the difference between a municipality's annual surplus or deficit as reported on the Statement of Operations and the change in net financial assets or net debt reported in the Statement of Financial Position.

The What

The Consolidated Statement of Change in Net Financial Assets (Net Debt) starts with the annual surplus (or deficit), and identifies changes in non-financial assets that will utilize or add to the surplus amount, to derive a net change in financial assets. To this the net financial assets balance held at the beginning of the year is added, to come up with a year-end balance, which reconciles back to the Statement of Financial Position.

Note that this is a new statement that was not prepared and included in current Canadian municipal annual financial reports (pre-2009).

The Why

The figures for net financial assets (or net debt) are already reported on the Statement of Financial Position. The Statement of Change in Net Debt reports the items that explain the difference between the surplus or deficit from operations and the change in net financial assets (or net debt) for the period. This statement of change provides important accountability information regarding the extent to which the expenditures of the accounting period are met by the revenues recognized in the period. The Statement of Change in Net Financial Assets (or Net Debt) must report the acquisition of tangible capital assets in the accounting period as well as other significant items that explain the difference between the surplus or deficit for the accounting period and the change in net debt in the period. Other significant items that explain the difference between the surplus or deficit for the accounting period and the change in net debt in the period may include:

- (a) the amortization of tangible capital assets;
- (b) the net carrying amount of any tangible capital assets disposed of;
- (c) any adjustments relating to write-downs of tangible capital assets;
- (d) any interest capitalized in the period as a function of constructing or developing tangible capital assets;
- (e) any other expenditures, such as those for salaries and benefits of employees, capitalized in the period as a function of constructing or developing tangible capital assets;
- (f) the consumption of other non-financial assets;
- (g) expenditures to acquire other non-financial assets, such as prepaid expenses; and
- (h) other comprehensive income arising in applying the modified equity method when reporting on the results of government business enterprises and government business partnerships.

This statement is crucial because one of the main items that explains the difference between the annual surplus (deficit) and net financial assets (net debt) is the municipality's acquisition of tangible capital assets during the year, which are now recognized as assets held by the municipality. Note that the annual surplus (or deficit) recognizes the costs of using assets over their expected life spans by recording the cost of that notional consumption. The cost of the asset is expensed over many future periods as amortization, or depreciation.

When calculating the change in net debt, the municipality will recognize the whole cost of the asset at the time it is purchased, as this will be a utilization of a financial asset to acquire a non-financial one, with a resulting reduction in net financial assets. Thus the asset is fully recognized at time of acquisition, with the consumption of that asset over time recorded as an expense. This is simply looking at and using the same financial information, but from two different perspectives.

The new accounting standards require the reporting of budgeted numbers in this statement, so that readers can compare what actually happened to what was planned. Thus what may have been lost through the redundancy of Schedule 2B (Capital Fund activities), and the exclusion of capital acquisition transactions in the Statement of Operations, will be captured in this statement.

Again, this does not change what has happened operationally at all, but the reporting perspective has definitely changed.

The Implications

To prepare this Statement, you will be providing figures for the various items listed in the previous section. These should be readily obtainable from your accounting system, or whatever off-line system you may be using for accounting for your tangible capital assets. For example, you would easily obtain the amortization expense amount to use by doing an enquiry in your accounting system on the "amortization expense" account for the year 200x. And so on for the other items. Note that the numbers used here, such as amortization expense or proceeds on sale of tangible capital assets, will usually be included in the numbers appearing in the Statement of Operations, but not broken out. The sample statement presented in the previous newsletter makes this look more obvious than it is, because we separated out the full accrual reporting items to make it easier to see and understand the difference between the two formats.

These are added up, and can be reconciled to the Net Financial Assets line in the Consolidated Statement of Financial Position (line 28).

Note that this Statement requires the inclusion of budget numbers for each item, which allows the reader to see what your municipality's net financial assets (or net debt) were at the end of the year, compared to what it was forecasted to be. This also includes the budget figure for TCA acquisitions, so that your capital budget or capital investment plan for the year will be linked to your financial statements as well.

The Changes

As an appendix to this newsletter, there is one relevant financial statement:

Statement 3B - Consolidated Statement of Changes in Net Financial Assets – new format

Note that there is no **Statement 3A**, because Irgendwo was not required to prepare and present a statement of this type in its annual financial reporting in the published format – so did not.

Statement 3B is a completely new statement required to support the new financial reporting model. Irgendwo has followed the format in the Handbook, Section 1200.Appendix B, page 1200(28).

The starting point is the annual surplus shown on line 66 in the Consolidated Statement of Operations (see last page of previous Newsletter). If operations were all cash based or using cash equivalents, net financial assets would increase by this amount.

Lines 12 to 22 show a number of items that increase or decrease the net financial assets of the municipality, as the case may be. For example, the annual surplus (or deficit) is net of amortization expense. This was a non-financial transaction that reports the notional consumption of tangible capital assets, but which has no impact at all on the net financial assets of the municipality. So the amount is added in. Conversely, the investment made in tangible capital assets during the year must be deducted, because financial assets were given up in exchange for these non-financial ones. It makes no difference whether you pay cash or issue debentures, your net financial assets (or net debt) position will be exactly the same, as you are choosing between giving up a dollar of assets, or accepting a dollar of liability. Either way, your net financial assets are reduced by a dollar.

The other items have no budget figures shown, as these would not normally be budgeted for. Collectively, the various changes indicated give the actual net change for the year of $48,645,000.

When the beginning of the year valuation is added on, it gives the 2007 year end total, which reconciles back to line 28 on the Consolidated Statement of Financial Position. Thus you can see again how each Statement ties back to the Consolidated Statement of Financial Position, to provide a total integrated picture, just as the Schedules and Notes tie back to the appropriate Statements in the same way.

Summary

This is a walk-through of the Consolidated Statement of Changes in Net Financial Assets (or Net Debt), and the changes that will be required as a result of implementing full accrual accounting, as they relate to this specific report. This Statement was covered in some detail at the MFOA/AMCTO Spring 2009 workshops, and the presentation materials can be found on-line at the MFOA/AMCTO PSAB Asset Management website.

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Our next newsletter will look at the next major financial statement, The Consolidated Statement of Cash Flow.

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

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Statement 3B - Consolidated Statement of Changes in Net Financial Assets – new format

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO

Consolidated Statement of Change in Net Financial Assets

Year ended December 31, 2007

(in thousands of dollars)

	2007		2006
	Budget	**Actual**	Actual
ANNUAL SURPLUS	**18,102**	**84,575**	63,856
Amortization of tangible capital assets	**123,456**	**125,681**	122,718
Acquisition of tangible capital assets	**(151,194)**	**(169,443)**	(195,743)
(Gain)/loss on sale of tangible capital assets	**0**	**(2,672)**	1,998
Proceeds on sale of tangible capital assets	**0**	**5,406**	1,133
Write-downs on sale of tangible capital assets	**0**	**0**	0
Transfers of capital assets	**0**	**5,816**	800
Acquisition of supplies inventories	**0**	**0**	0
Acquisition of prepaid expense	**0**	**(987)**	0
Consumption of supplies inventories	**0**	**269**	0
Use of prepaid expense	**0**	**0**	0
INCREASE (DECREASE) IN NET FINANCIAL ASSETS	**(9,636)**	**48,645**	(5,238)
NET FINANCIAL ASSETS, BEGINNING OF YEAR	**212,853**	**212,853**	218,091
NET FINANCIAL ASSETS, END OF YEAR	**203,217**	**261,498**	212,853

The accompanying notes and schedules are an integral part of these financial statements.