

# PSAB/Asset Management

NEWSLETTER NO. 56

## ACCUMULATED SURPLUS OR (DEFICIT)

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Newsletter #52 took you through the new Consolidated Statement of Financial Position that you will be preparing, starting with fiscal 2009, and we noted that the bottom line on that statement will be the Accumulated Surplus (Deficit). If you add Assets and Non-financial Assets, and Liabilities and Accumulated Surplus, the totals balance as in the traditional balance sheet, hence the name. However, the presentation format used for the Statement of Financial Position highlights very graphically the two key performance indicators that the new financial reporting model seeks to provide - the net financial assets or net debt of the municipality, and the accumulated surplus or deficit. The two indicators together explain the financial position as of the financial statement date (PS 1200.038).

This residual balance that is assets less liabilities must be presented as a one-liner on the Statement of Financial Position. When a government chooses to provide information about any funds or reserves, it does so only in the notes and schedules and not on the Statement of Financial Position (PSG-4, paragraph 7). However, you are going to have to disclose what the accumulated surplus (or deficit) really means, or what is included in that amount, so that your readers have a better understanding as to how you are managing your resources. Not least, you will have to demonstrate that an accumulated surplus is not an excuse to go on a spending spree, just as an accumulated deficit is not grounds for filing for the municipal equivalent of Chapter 11 protection.

This concept of accumulated surplus is such a significant change from current practice that it merits a discussion on its own. Irgendwo has decided to include a new schedule (Schedule 7) in its Annual Financial Report for reporting on the components of its Accumulated Surplus.

**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.**

### **The What**

The Consolidated Schedule of Accumulated Surplus provides a detailed breakdown of what has given rise to the surplus (or deficit), or of the intended uses of the surplus amount, and of shortfalls, in the case of a deficit. It is split into two segments: Reserve Funds and Reserves, which are financing that has been accumulated in advance of a future need or requirement; and Surpluses, which are like net profit, in that financing has exceeded obligations and liabilities to leave a net balance.

There has been considerable discussion over the name Accumulated Surplus in Ontario, as *surplus* has a specific connotation in the Ontario Municipal Act. Municipalities are legally required to use last year's entire surplus from operations towards financing this year's activities, and for determining an appropriate property tax rate. (289.3(a) – upper-tier, 290.3(a) – local municipality). One municipality pointed out that if that applied to its accumulated surplus, property tax requirements for the next four years would be zero, at which point, the municipality would be completely broke. Clearly that would not work, and the Ministry of Municipal Affairs and Housing does understand that this discussion is about a different kind of surplus.

Note that allocations to or draws from reserves and reserve funds no longer manipulate the annual surplus reported. This is because reserve and reserve funds now are reported as committed components of the net economic resources of the municipality, along with the other components of the Accumulated Surplus (Deficit), which have not been committed for any special purpose.

In the private sector, this total amount would appear on the Balance Sheet as Shareholders' Equity or Owners' Equity, composed of share capital issued and Retained Earnings.

In the municipal world, there is really no analogy to that. While the amount could be called *municipal equity*, who owns the equity, and is it really equity, or more like assets in trust? In any case, it is not the role or function of a government to raise financing in order to generate a return on capital, or to pay dividends to stakeholders. A municipality will raise financing in advance of its requirements, but this is in order to be able to finance the future provision of goods and services, from which there definitely is no guarantee of revenue generation or of return on investment. To sum up, these are the net economic resources available to the municipality for the future provision of programs and services.

While the amount in question is probably most analogous to Retained Earnings, this would be a misnomer, as the private sector is focused on generating earnings, or accumulated net profit, whereas the municipal focus is on the professional provision of services done well, and any surplus generated is a fortuitous by-product.

Where financing is received for specific capital purposes, this is effectively given in trust, such as development charges which are used for capital investments. This financing is not part of the *capital* of the municipality, in the sense that share capital is a property interest in a corporation.

After careful consideration, the Public Sector Accounting Board determined that the name Accumulated Surplus (Deficit) is perhaps the best way of describing this residual balance that a government will be showing in its statements. This has been described as the government's "reported net economic resources", which are resources useful for carrying out economic activities, such as consumption, production and exchange. ("20 Questions about Government Financial Reporting". CICA/PSAB, page 27). What is ultimately of importance to a reader are the assets held by the municipality, and the debts owed or liabilities outstanding.

## **The Why**

The Public Sector Accounting Handbook PS 1200 requires you to report on the Accumulated Surplus (Deficit) in the Consolidated Statement of Financial Position, as a net bottom line, or assets minus liabilities plus net non-financial assets. Whether you report in more detail is at your discretion, though your readers will doubtless expect some reporting of what the municipality expects to do with the surplus amount, or to address the accumulated deficit, if that is your lot. Politically, you will want to show that these are provisions for future requirements, rather than a windfall available for use now.

The suggested Schedule is a convenient and concise way of doing this that also shows how the allocations have changed, compared to the previous year. You may have further supporting information presented in the Notes and in other Schedules, such as Schedules 3 and 4, or in Note 5 (to be discussed in the next newsletter).

## **The Implications**

This is a completely new schedule, but the information presented is directly related to other information contained in the Financial Statements, other Schedules and the Notes found in the annual financial report. Here it is presented in a different format. Again, it is much the same information, but from a different perspective.

## **The Changes**

As an appendix to this newsletter, there are 4 relevant financial schedules:

Schedule 3A - Consolidated Schedule of Reserves and Reserve Funds – Financial Activities and Fund Balance – published format;

Schedule 4A and 4B - Consolidated Schedule of Continuity of Reserve Funds – both formats;

Schedule 3B - Consolidated Schedule of Continuity of Reserves – new format and

Schedule 7B - Consolidated Schedule of Accumulated Surplus – new format.

**Schedules 3A and 4A** were published in Irgendwo's 2007 Annual Financial Report, and, again, these statements and their formats would probably be familiar to any regular reader of Canadian municipal financial reports. Note how they show the amounts transferred to and from the Operating Fund and the Capital Fund, as part of the respective financing activities for each fund.

You will want to retain Schedule 4 as is in your new financial statements. This schedule very conveniently documents the changes in reserve funds, and explains the difference between the respective numbers in Schedule 7, thus taking the information provided to a greater level of detail. This schedule would not change, as you will still want to show what was transferred to operations and to capital investments. It also ties into your operating and capital budgets, in terms of documenting the transfers to and from reserve funds.

Schedule 3 in its current format will have little relevance in the new version of your Annual Financial Report. **Schedule 3B** is a reworking to provide the same kind of detailed information for reserves that Schedule 4B provides for reserve funds, using the same layout. The summary information for reserves is currently presented in Note 5 in the Notes to the Consolidated Financial Statements (see next newsletter). There is no Interest on Investments amounts for Reserves, because Reserves do not earn interest, by definition. The bottom line of Schedule 4 has been added, to reconcile back to Note 5 and to the original Schedule 3A.

While optional, Irgendwo's Council wants to see the detail contained in Schedules 3B and 4B, so staff prepare them. Your Council may want to see this level of detail too.

**Schedule 7B** is completely new, and is designed to show the intended uses and purposes of the accumulated surplus.

The first major section of Schedule 7B is Reserves and Reserve Funds, presented on the first page of this schedule. Reserve Funds numbers are simply the year-end balances shown on Schedule 4. The numbers

shown for Reserves come from the numbers in Schedule 3B. Irgendwo currently includes the information on Reserves as a note, rather than as a separate schedule. By putting this information in a revamped Schedule 3B, the two sets of detailed information will be presented together in the annual financial report, making it easier for the reader to see what has happened.

The other major section on the second page of the schedule documents what are the actual surpluses of the municipality. The first four items represent the net investment made in Irgendwo's tangible capital assets up until December 31, 2008. Remember that up until the end of 2008, we recorded all payments towards the acquisition of tangible capital assets as expenditures in the year when they occurred. You obtained the financing for them from wherever, paid for them, and the expenditure was reported no differently than were it rent or salaries, save that it occurred in the Capital Fund.

In 2009, these assets are to be reported as TCAs at net book value (total historical costs, less accumulated amortization up to December 31, 2008). The debit entry is the net book value, which appears under Non-financial Assets in the Statement of Financial Position. The credit entry is to Accumulated Surplus. Since you had never capitalized the amounts, this entry would be analogous to a prior period adjustment to Retained Earnings in the private sector, as you are effectively now restating what was originally reported as an expense against income as the purchase of a non-financial asset. Thus income would have been increased, ergo so is the accumulated surplus as a result.

The next figure, General Revenue Fund, is what we traditionally understand as year-end surplus from Operations. This is the amount that would be fully utilized in the financing for the next budget year. It is also the only amount on this Schedule that could be considered as available money for programs, without any strings attached.

Other is a group of smaller interests that the municipality has, such as agencies, boards and commissions, which are consolidated into the municipality's annual financial report.

Finally, we now report on future unfunded liabilities that the municipality has, which has traditionally been reported as "to be recovered in future years". These are now reported as a liability in the Consolidated Statement of Financial Position (see Newsletter #52, Statement 1B), so that this liability will be reported as being like a draw against the accumulated surplus, reducing the net total of all surpluses, as shown on Schedule 7B. Again, this shows how the Accumulated Surplus (Deficit) will represent your municipality's "reported net economic resources".

As stated in the "20 Questions" publication cited earlier, the accumulated surplus (deficit) of a municipality will be an important additional indicator of a municipality's financial position, as this tells the reader what net resources are available to provide future services. Schedules 7, 3B and 4B provide important and useful additional information about the numbers on the Accumulated Surplus (Deficit) line on the Consolidated Statement of Financial Position (line 36).

## **Summary**

This is a walk-through of the suggested Consolidated Schedule of Accumulated Surplus, which provides a detailed breakdown of the bottom line of the Consolidated Statement of Financial Position. This Schedule 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.

We have also suggested that the former Schedule 3 could be revamped to provide more information on the municipality's reserves. Please remember that Schedules 3, 4 and 6 discussed in this Newsletter are

optional. However, you will probably want to use these formats, in order to keep your four Financial Statements more concise and more understandable.

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Our next newsletter will look at the Notes to the Consolidated Financial Statements. How will they change as a result of the accounting change?

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

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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.

Schedule 3A - Consolidated Schedule of Reserves and Reserve Funds – Financial Activities and Fund Balance – published format

1 **THE CORPORATION OF THE DISTRICT**  
 2 **MUNICIPALITY OF IRGENDWO**  
 3 **Consolidated Schedule of Reserves and Reserve**  
 4 **Funds Financial Activities and Fund Balance**  
 5 **Year ended December 31, 2007**

(in thousands of dollars) **Schedule 3**

	<u>2007</u>		<u>2006</u>
	<u>Budget</u>	<u>Actual</u>	<u>Actual</u>
	(Note 16)		
10 REVENUES			
11 Interest	0	9,881	7,684
12 <b>TOTAL REVENUES</b>	<b>0</b>	<b>9,881</b>	<b>7,684</b>
13			
14 TRANSFERS			
15 Transfer from Operating Fund	46,305	98,060	75,491
16 Transfer to Capital Fund	(36,383)	(47,836)	(55,773)
17 Transfer to Operating Fund	(6,198)	(7,936)	(13,082)
18 <b>NET TRANSFERS</b>	<b>3,724</b>	<b>42,288</b>	<b>6,636</b>
19			
20 CHANGE IN FUND BALANCE	3,724	52,169	14,320
21			
22 FUND BALANCE, BEGINNING OF YEAR		358,464	344,144
23 <b>FUND BALANCE, END OF YEAR</b>		<b>410,633</b>	<b>358,464</b>

**Schedule 4A and 4B - Consolidated Schedule of Continuity of Reserve Funds – both formats**

1 **THE CORPORATION OF THE DISTRICT**  
 2 **MUNICIPALITY OF IRGENDWO**  
 3 **Consolidated Schedule of Continuity of Reserve Funds**  
 4 **Year ended December 31, 2007**  
 5 (in thousands of dollars)

**Schedule 4**

	BALANCE, BEGINNING OF YEAR	REVENUES /CONTRIBU TIONS			TRANSFER S			BALANCE END OF YEAR
		Interest on Investments	From Operating Fund	Total	To Operating Fund	To Capital Fund	Total	
	\$	\$	\$	\$	\$	\$	\$	
10 Treatment plant/rate stabilization								
11 Sanitary sewerage	43,402	1,930	9,120	11,050	0	0	0	54,452
12 Water supply	25,499	1,090	4,911	6,001	0	10,000	10,000	21,500
13 District share of non-residential								
14 development								
15 Sanitary Sewage Works	3,737	163	0	163	0	0	0	3,900
16 Water supply	2,938	129	0	129	0	0	0	3,067
17 Solid waste management	10,628	508	2,580	3,088	0	0	0	13,716
18 General levy stabilization	45,622	2,015	21,288	23,303	2,965	0	2,965	65,960
19 Industrial land	1,329	58	0	58	0	0	0	1,387
20 Foreign exchange	4,223	185	0	185	0	0	0	4,408
21 Workers' compensation	21,229	949	991	1,940	20	0	20	23,149
22 Tri-District sanitary sewerage system	4,151	192	231	423	0	90	90	4,484
23 Insurance	13,031	539	1,936	2,475	1,756	0	1,756	13,750
24 Social housing	9,670	462	1,368	1,830	0	0	0	11,500
25 Roads rehabilitation	864	433	9,025	9,458	0	9,045	9,045	1,277
26 Asset Management	19,893	1,029	3,638	4,667	0	6,254	6,254	18,306
27 Other miscellaneous reserve funds	2,933	199	3,017	3,216	942	0	942	5,207
28 Total	209,149	9,881	58,105	67,986	5,683	25,389	31,072	246,063





Schedule 7B - Consolidated Schedule of Accumulated Surplus – new format

1 <b>THE CORPORATION OF THE DISTRICT</b>		
2 <b>MUNICIPALITY OF IRGENDWO</b>		
3 <b>Consolidated Schedule of Accumulated Surplus</b>		
4 <b>Year ended December 31, 2007</b>		
5 (in thousands of dollars)	<b>Schedule 7</b>	
6	7	8
	<u>2007</u>	<u>2006</u>
9 RESERVE FUNDS - Schedule 4		
10 Treatment plant/rate stabilization		
11 Sanitary sewerage	<b>54,452</b>	43,402
12 Water supply	<b>21,500</b>	25,499
13 District share of non-residential development		
14 Sanitary Sewage Works	<b>3,900</b>	3,737
15 Water supply	<b>3,067</b>	2,938
16 Solid waste management	<b>13,716</b>	10,628
17 General levy stabilization	<b>65,960</b>	45,622
18 Industrial land	<b>1,387</b>	1,329
19 Foreign exchange	<b>4,408</b>	4,223
20 Workers' compensation	<b>23,149</b>	21,229
21 Tri-District sanitary sewerage system	<b>4,484</b>	4,151
22 Insurance	<b>13,750</b>	13,031
23 Social housing	<b>11,500</b>	9,670
24 Roads rehabilitation	<b>1,277</b>	864
25 Asset Management	<b>18,306</b>	19,893
26 Other miscellaneous reserve funds	<b>5,207</b>	2,933
27		
28 Total	<b>246,063</b>	209,149
29		
30 RESERVES (Schedule 3)		
31 Working capital	<b>31,435</b>	29,791
32 Property tax assessment appeals	<b>12,840</b>	12,520
33 Equipment replacement	<b>18,231</b>	13,578
34 District roads	<b>4,211</b>	4,030
35 Contingencies	<b>400</b>	400
36 Sick leave gratuity payments	<b>39,123</b>	34,862
37 Capital	<b>50,045</b>	47,133
38 Homes for the aged	<b>1,133</b>	1,133
39 Employee benefits	<b>5,161</b>	4,283
40 Irgendwo Centre for the Arts	<b>1,991</b>	1,585
41		
42 Total	<b>164,570</b>	149,315
43		
44 Total - Reserves and Reserve Funds	<b>410,633</b>	358,464

Schedule 7B - Consolidated Schedule of Accumulated Surplus – new format (continued)

45 **THE CORPORATION OF THE DISTRICT**

46 **MUNICIPALITY OF IRGENDWO**

47 **Consolidated Schedule of Accumulated Surplus (continued)**

48 **Year ended December 31, 2007**

49 (in thousands of dollars)

**Schedule 7**

	<u>2007</u>	<u>2006</u>
50		
51		
52		
53	<b>410,633</b>	358,464
54		
55	<b>SURPLUSES</b>	
56	<b>3,088,247</b>	3,038,586
57	<b>243,751</b>	253,539
58	<b>104,272</b>	101,380
59	<b>112,358</b>	118,054
60	<b>4,988</b>	5,028
61	<b>4,706</b>	2,958
62		
63	<b>(103,771)</b>	(98,172)
64	<b>(9,864)</b>	(9,092)
65		
66	<b>3,444,687</b>	3,412,281
67		
68	<b>3,855,320</b>	3,770,745