

PSAB/Asset Management

NEWSLETTER NO. 6

The Case for PS 3150: Part I

by Dan Cowin, Executive Director, MFOA

We have had a number of calls from members asking for the rationale for accounting for tangible capital assets. To help our members understand the case for PS 3150, and to help you explain it to your councils, we have prepared this overview. It draws heavily from a Research Report commissioned by the Canadian Institute of Chartered Accountants (CICA) in 2002 entitled *Accounting for Infrastructure in the Public Sector*.¹ Although the study relates to infrastructure as defined by the Study Group, their findings relate to all tangible capital assets of local governments.

The objective of the report was to explore alternatives for accounting and reporting on infrastructure and to determine what information about infrastructure could and should be provided by governments. The Study Group identified 10 tasks that would comprise its terms of reference. Among other things, the Study Group sought to:

- Summarize the reasons for, and the purpose of, reporting infrastructure in a government's financial statements
- Determine whether current accounting practices meet the information needs, and
- Consider what information should be generated and reported about infrastructure assets in order to provide accountability to a government's financial statements about how assets are being managed.

The Problem:

The Study Group concluded: "Information about stock, its condition and the costs associated with using infrastructure is not being provided."² The Report recognized that many governments have detailed engineering information systems, but there are significant gaps in the financial information needed by staff and politicians to make proper decisions with regard to resource allocation. The lack of knowledge about the costs of using assets and fully maintaining them limits council's ability to make important financial decisions or to know if existing financing policies are appropriate and adequate. The Report notes that a lack of knowledge of the costs related to infrastructure will make it difficult for governments to:³

¹ CICA, [*Accounting for Infrastructure in the Public Sector*](#), (Toronto, 2002). Although this work was commissioned by the CICA, the views expressed are not necessarily endorsed by the CICA. The views of the Report are those of the study group that wrote the report.

² Ibid., p 11.

³ Ibid., pp. 12 -15.

- Assess overall spending priorities
- Establish infrastructure spending priorities
- Determine the sufficiency of tax and user fee rates
- Assess accountability for the resources provided
- Make judgments about performance
- Assess financial sustainability, flexibility and vulnerability
- Make cost comparisons

The Need:

The Study Group concluded that governments need improved information to make sound financial decisions, particularly information related to the use and maintenance of public assets. To achieve the goal of improved information, the Study Group recommended that: ⁴

- Infrastructure should be reported as an asset.
- The cost of using infrastructure should be reported.
- Infrastructure should be depreciated over its useful life.
- Information about infrastructure condition should be provided.

Benefits:

The Study Group felt that its recommendations would help address financial information gaps. The Group identified a number of benefits in having better information with regard to the stock of infrastructure.⁵

- Provides a proper context and inventory against which maintenance, renewals, replacement, funding, financing and rate setting decisions can be debated
- Establishes a common basis of measurement, allowing for enhanced comparability;
- Provides a useful starting point and basis for evaluating the condition of infrastructure on a regular basis and for highlighting changes in its condition over time
- Is useful in identifying the local government's flexibility in responding to a community's changing service demands
- Helps decision makers assess the long term sustainability of existing debt loads, current program costs, and the need for future infrastructure replacement or improvements
- Contributes to the evaluation of contingencies related to infrastructure by understanding the type of infrastructure a local government has and, thus, identifying types of unexpected events that could arise from those systems

⁴ Ibid., pp. 3-4.

⁵ Ibid. p. 30.

The Study Group also felt that its recommendations would provide better information on service costs that would have a number of benefits. Specifically, municipal managers and councils would be better able to:⁶

- Understand service costs
- Choose among various service delivery methods
- Assist in cost reduction initiatives
- Establish full cost fees and charges⁷
- Establish budgets and analyze variances
- Benchmark activities and assess performance
- Improve accountability for allocation and use of resources

PSAB 3150:

Stock: PS 3150 does not incorporate all of the recommendations made by the Study Group. It does not, for example, require that information on deferred maintenance be included as part of the information on infrastructure condition. However, it does require that certain types of basic information on the stock, use and condition of infrastructure be provided.

PS 3150 will require an inventory and valuation of all assets owned by the municipality and the various entities that are consolidated within its financial statements. There are some exceptions, including:

- Certain Crown lands not purchased by the municipality
- Works of art or historical treasures
- Intangible assets (e.g. goodwill, trademarks, copyright)
- Assets related to government business enterprises, which are accounted for on a modified equity basis

In addition, assets will not be included where they do not have a material impact on the finances of the municipality, even though they meet the definition of an asset provided in PS 3150.⁸

⁶ Ibid., pp. 33-35.

⁷ Water Strategy Expert Panel, *Watertight: The Case for Change in Ontario's Water and Wastewater Sector*, Toronto, 2005. The report argues that over the next 15 years there will be an investment gap in water and wastewater of approximately \$18 billion based on historic investment rates. The report argues that many jurisdictions are not on a full cost recovery basis for water and wastewater services.

⁸ Section 1200.015 of the PSAB handbook states: "Public Sector Accounting Standards and Guidelines need not be applied to immaterial items. Materiality is a matter of professional judgment in the particular circumstances. Materiality may be judged in relation to the reasonable prospect of its significance in the making of assessments and judgments by the users of financial statements. A material item would be expected to affect assessments of and judgments on government financial operations and management."

For a complete definition of capital assets see the PSAB handbook section PS 3150.05a, which is also replicated on p.10 of the revised [OMBI Guide](#).

Use: PS 3150.09 requires that tangible capital assets be recorded at cost. Section 3150.22 states that “the cost, less any residual value, of a tangible capital asset with a limited life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the government.” The annual depreciation, which is reported as an expense on the statement of operations (PS 3150.23) is a proxy for the degree to which assets are consumed in a given year. The Study Group recognized the limitations of using historic depreciated costs, especially for infrastructure with long useful lives. This issue will be discussed further in Part II.

Condition: Although PS 3150 does not require a detailed asset management plan and condition rating for tangible capital assets, it does require that the value of assets reflects any betterments or improvements that would extend their life. It also requires write-downs for assets where the service life has been impaired in some fashion. The topic of betterments and write-downs are dealt with in OMBI’s [Municipal Guide to Accounting for Tangible Capital Assets, version 2](#). We will soon deal with these topics in upcoming Newsletters as well as in the spring training sessions being planned with the AMCTO and OMBI. The concepts of betterments and write-downs are important to keep in mind and understand as you gather information about your assets.

Upcoming Newsletters

Our next Newsletter, The Case for PS 3150 Part II, will review the debate about using historic costs versus renewals accounting or the use of replacement costs.

If you have questions about PS 3150 that you think should be addressed in upcoming Newsletters please forward them to Dan Cowin at MFOA (dan@mfoa.on.ca). We cannot guarantee to deal with every question put to us, but we will make every effort to deal with as many as possible.

Resources:

1. CICA, [Accounting for Infrastructure in the Public Sector](#), (Toronto, 2002). (Note: this report is not available on the internet. Follow the link for a high level summary and to order the document on line).
2. CICA, [Accounting for Infrastructure in the Public Sector: Executive Summary](#), (Toronto, 2002)
3. Tim Beauchamp, [“The Infrastructure Web”](#), in *CA Magazine.com*, (June-July, 2002)
4. Tim Beauchamp, [Accounting for Infrastructure - Research Report](#)
5. CICA, [Reporting Model and Tangible Capital Assets](#),
6. Martha Jones Denning, [“Governments are Different”](#) in *CA Magazine.com*, (December 2000).

We invite you to let us know if there is an issue that you would like to see addressed in the Newsletters. We are also interested in having our members submit anything that you come across with regard to tangible capital assets, financial reporting, asset management or long-term financial planning including any reports or presentations that you have given or prepared that could be of use to others.

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

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