

# PSAB/Asset Management

## NEWSLETTER NO. 7

### The Case for PS 3150: Part II

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In [Newsletter 6](#), we indicated that the best source for those interested in the case for PS 3150 was a CICA research report entitled [Accounting for Infrastructure in the Public Sector](#) (2002). Newsletter 6 summarized the findings of the report with regard to government reporting for infrastructure but did not deal with the issue of why the Study Group recommended that infrastructure be recorded at historic costs and depreciated. This Newsletter will summarize the Study Group's comments on this issue.

As noted previously in [Newsletter 6](#), the Study Group recommended that governments report on the stock, use and condition of infrastructure. The stock of infrastructure is the dollar value of all of the assets a government owns. The Study Group considered whether to value assets based on historic costs or replacement costs. With regard to the use of infrastructure, the Study Group recommended that the financial statements recognize the cost of using assets annually, reflecting the fact that the ability of assets to provide service is reduced over time.

#### *Historic Cost Approach Preferred*

With regard to the stock of assets, the Study Group concluded that they should be assigned values based on historic costs because they are:<sup>1</sup>

- Reliable:<sup>2</sup> “Information is reliable when it agrees with the actual transactions and events to which it relates, is capable of independent verification, and is reasonably free from error and bias. Historical cost represents *prima facie* evidence of economic value at the time of acquisition.”<sup>3</sup>
- Verifiable: Historic costs were seen to provide a “consistent, verifiable foundation upon which to make estimates of future replacement costs or market values. Applying any other approach would necessarily require accounting for increases or decreases in the reported infrastructure “value” to be estimated and recorded in the statement of financial position, with a corresponding adjustment to either the equity or income accounts.”<sup>4</sup>

<sup>1</sup> CICA, [Accounting for Infrastructure in the Public Sector](#) (2002), pp.54-55.

<sup>2</sup> CICA, PSAB Handbook. PS 1000 deals with financial statement concepts. Key qualitative requirements for financial statements include: relevance, reliability, comparability and understandability and clear presentation. See PS 1000.23 to PS 1000.31.

<sup>3</sup> CICA, [Accounting for Infrastructure in the Public Sector](#) (2002), p. 54.

<sup>4</sup> Ibid. p. 54.

- Commonly adopted by standard setters: Historic cost has been accepted by standard setters around the world, is well understood and remains the preferred method for accounting for capital assets.

### *Historic Costs Not Sufficient*

The Study Group did recognize the criticisms associated with the use of historic costs. The Study Group noted that “from a public perspective, many have indicated that using historical cost is meaningless, given the long life characteristics of infrastructure.”<sup>5</sup> In response to this criticism, the Study Group examined the use of current or replacement costs to value the stock of infrastructure, but identified a number of problems with it.

- Future costs are difficult to predict, especially for assets with long lives. Estimating future costs over long periods is difficult and uncertain. The Study Group stated that: “While there is value in reporting inflation/deflation adjustments to infrastructure on a current cost basis, until the issue of accounting for inflation is addressed, the Study Group believes that the continued application of historical cost measurement is appropriate.”<sup>6</sup>
- Technology can change over time. Costs may be more or less than costs experienced today. An asset may be replaced by something quite different in the future.
- Using replacement costs “skews the relationship among existing costs currently being reported on the financial statements. This is because the current operating costs associated with the existing asset are included with the replacement costs being determined on a difference type of asset that is not yet owned by the government.”<sup>7</sup>

### *Additional Information Needed*

Notwithstanding the problems in using replacement costs in financial statements, the Study Group recognized that financial statements do not provide the full range of information about assets that Councils and senior managers need. The Study Group recommended that governments undertake condition assessments and infrastructure management plans and track deferred maintenance.<sup>8</sup> Specifically, the Group said:

Financial information alone cannot provide the necessary information to help users understand the condition of the stock of a government’s infrastructure. The information contained in the financial statements must be supplemented by other non-financial information. That information could be described in terms of the categories and types of assets, the methods used for performing condition assessments, an overall rating for

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<sup>5</sup> Ibid. p. 55.

<sup>6</sup> Ibid. p. 58.

<sup>7</sup> Ibid. p. 58.

<sup>8</sup> Ibid. ch. 7.

each class of asset, amounts needed to return the asset to an acceptable condition, and amounts needed to future reconstruction.<sup>9</sup>

The Study Group strongly recommended that governments undertake infrastructure management plans.

A clear and consistent framework is needed for infrastructure planning and investment, determining ongoing operations needs and assessing its condition over time. Such a framework must include: a government strategy that sets out the overall objective related to infrastructure; the organizational structure of the government; an extensive inventory of the infrastructure; life-cycle needs and costs; preventative strategies; various condition assessment models, in order to address the various types of infrastructure; and appropriate economic valuation tools. **The central feature to developing these plans is having an inventory of infrastructure** (emphasis added).<sup>10</sup>

### *Conclusion*

The Study Group concluded that for accounting purposes of the financial statements, historic costs were the best approach. However, the Group recognized the shortcomings of using historic costs, as well as using depreciation as a measure of the use of infrastructure. They dealt with this by recommending that governments collect and provide supplementary information in the form of reports on the condition of assets and infrastructure management plans. The starting point for such plans lies in having a good asset inventory. Future Newsletters will focus on assets and the information that you might wish to include in your asset inventory.

As always, 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.

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<sup>9</sup> Ibid. p. 69.

<sup>10</sup> Ibid. p. 73.