



August 31, 2005

Tim Beauchamp  
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Dear Tim:

This is in response to your July 21, 2005, request for comments on PSAB's proposed application of TANGIBLE CAPITAL ASSETS, Section PS 3150, to local governments and the proposed Guideline requiring local governments to disclose information in the notes to their financial statements in the interim.

On receiving the request, the Municipal Finance Officers Association (MFOA) and the Association of Municipal Managers, Clerks and Treasurers of Ontario (AMCTO) formed a joint committee of their members to review PSAB's proposals. The list of committee members is enclosed. Please note that members participated as individuals—not as official representatives of their municipalities.

A majority of the review committee supports the application of Section PS 3150 to local governments, believing that it will enhance accountability by highlighting the capital component of service delivery costs and offer insights into the implications of infrastructure renewal decisions. Enclosed are the detailed comments from this group in the form of a completed version of the questionnaire that accompanied your July 21 request.

As you will see, while supporting most of PSAB's seventeen proposals in principle, the group also notes that the valuation of existing and future tangible capital assets as required by PS 3150 will mean an increase in workload for municipalities. For smaller municipalities where the required skills are in shorter supply, this workload impact will be particularly acute. Accordingly, the group has put forward a number of suggestions to simplify the process of complying with PS 3150. These include:

- Defining and prescribing consistent asset categories for use by all local governments
- Providing an expected range of useful lives, or additional guidelines, to facilitate reasonably consistent approaches for determining asset useful life estimates
- Recommending capitalization thresholds (could vary by annual revenue or size of municipality)
- Allowing a longer period before requiring full compliance with PS 3150

**It is critical that municipalities be given a reasonable lead time to prepare for PS 3150.** It would be a perverse effect of PS 3150 if, because they could not be ready by January 1, 2008,

# TANGIBLE CAPITAL ASSETS, Section PS 3150 & Guideline

**Please read the associates' draft TANGIBLE CAPITAL ASSETS, Section PS 3150 and the Guideline before answering this questionnaire.**

The purpose of this questionnaire is to determine whether you agree with the associate's draft of TANGIBLE CAPITAL ASSETS, Section PS 3150 that is intended to apply to all levels of government and the proposed Guideline is intended to apply to local governments only.

The Public Sector Accounting Board (PSAB) needs your views and input not only from applying Section PS 3150 to local governments but also the suggested changes being made to the Section for the purposes of other levels of government.

A series of questions have set out below requesting that you indicate your support for or disagreement with the proposal. The questionnaire also provides an opportunity for you to explain your reason(s) for your position.

Your response will be used by the task force and PSAB to assess the acceptability of the proposals.

Name: MFOA/AMCTO Joint Committee (Majority View)

Employer: \_\_\_\_\_

Province: Ontario

(This helps PSAB for purposes of profiling the responses in terms of type of respondent and geographic location)

## QUESTIONS

### Section PS 3150

Tangible capital assets are non-financial assets having physical substance that:

- (i) 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;
- (ii) have useful economic lives extending beyond an accounting period;
- (iii) have been acquired to be used on a continuing basis; and
- (iv) are not intended for sale in the ordinary course of operations. [3150.05 (a)]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The definition is in line with generally accepted accounting principles and should work for the local government sector. However, we wonder if item (iii) should not say “constructed, developed or acquired” in order to capture assets that a municipality produces rather than acquires from another party.</p>	<p>X</p>	

Cost is the gross amount or consideration given up to acquire, construct, develop or better a tangible capital asset, and includes all of the costs directly attributable to the acquisition, construction, development, or betterment of the tangible capital asset including installing the asset at the location and in the condition necessary for its intended use. The cost of a contributed tangible capital asset, including a tangible capital asset in lieu of a developer charge, is considered to be equal to its fair value at the date of contribution. The cost of a leased tangible capital asset is determined in accordance with LEASED TANGIBLE CAPITAL ASSETS, PSG – 2. [3150.05 (b)]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The historical cost approach to valuation is in line with generally accepted accounting principles and should, in principle, work for the local government sector.</p> <p>However, we note that Ontario municipalities owning a water and/or sewer system will be required under the Sustainable Water and Sewage Systems Act, 2002, to undertake a replacement costing and cost recovery modeling process for related tangible capital assets. Determining the replacement cost valuation and evaluating the condition these assets will be a costly exercise. That exercise would dovetail nicely with PSAB’s tangible capital assets reporting requirements and the costs by Ontario municipalities of complying with the act would be lower if replacement cost rather than historical cost were the basis of Section PS 3150.09. We understand, however, that PSAB may not be able to use replacement cost given the national scope of PSAB’s mandate.</p> <p>If the historical cost approach is followed, it is essential that PSAB provide clarification and guidance on the precision expected for determining historical cost, asset amortization period (equivalent to historical asset design life), remaining life of the asset, resulting net book values, etc. Ontario</p>	<p>X (in principle)</p>	

<p>municipalities specifically need to know whether applying the value by current fair market value against the ratio of remaining design life (i.e. current fair market value * estimated remaining life/estimated original design life) will be an acceptable methodology.</p> <p>Whatever the valuation methodology, there will be significant work involved for municipalities in establishing net book values. PSAB should explicitly recognize the burden being placed on municipalities in its communications plan so that it does not come as a surprise to municipal elected officials or the public.</p>		
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Tangible capital assets should be accounted for and reported as assets in the statement of financial position. [3150.07]

	Agree	Disagree
<p><b>Reason(s)</b></p> <p>The valuation of existing and future tangible assets can be greatly simplified if PSAB develop standards or guidelines governing:</p> <ul style="list-style-type: none"> <li>• asset categories</li> <li>• useful lives for each asset category (could vary by size and location of municipality, and/or other factors)</li> <li>• thresholds for capitalizing expenditures</li> </ul> <p>The guidelines or standards would not be iron-clad rules but “rules of thumb” designed to minimize debate between municipal management and auditors. Every municipality could develop its own standards where it can make the case for an alternative to the guideline or standard.</p> <p>The purpose is not only to reduce the administrative burden on municipalities, but also to promote comparability across the local government sector. Municipalities need to be able to demonstrate comparability to other local governments that are their local benchmarks. (The Ministry of Municipal Affairs &amp; Housing has indicated that the FIR will be reformatted to bring it into line with PS 3150.) If neighbouring municipalities adopt a significantly different design life for their watermains, for example, a municipality could be perceived as performing differently in the eyes of council and the public. Staff will be put in the position of explaining that a</p>	<p>X (in principle)</p>	

<p>difference arises out of an accounting practice rather than actual municipal performance. This is key difference between the private sector and government – the opportunity for public scrutiny and the need for readily understood explanations.</p> <p>The categories need to be discrete enough to add value and allow for meaningful comparison (i.e. "various utility systems" would be too broad — this could include water, electricity, and telephone utilities all in one for some municipalities)</p>		
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Tangible capital assets should be recorded at cost. [3150.09]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our comments above in relation to PS 3150.07.</p>	<p>X (in principle)</p>	

Capital grants would not be netted against the cost of the related tangible capital asset. [3150.10]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. Tangible capital asset should recorded at purchase cost. Cost is the “laid-down” cost, regardless of the funding source.</p>	<p>X</p>	

The cost, less any residual value, of a tangible capital asset with a limited useful life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the government. [3150.22]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our comments above in relation to PS 3150.07. Without some guidance about a relevant range to use when determining an asset's useful life, the risk is higher that useful lives will be selected, in part, to manipulate a municipality's annual reported surplus.</p>	<p>X</p> <p>(in principle)</p>	

The amortization period for a tangible capital asset should be limited to its useful life. [3150.23]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our comments above in relation to PS 3150.07. PSAB should develop standardized useful lives for different classes of assets to facilitate the task facing municipalities.</p>	<p>X</p> <p>(in principle)</p>	

The amortization of the costs of tangible capital assets should be accounted for as expenses in the statement of operations. [3150.24]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>This is an area of major concern because the details of how expensing the amortization or write down on a statement of operations will impact the net municipal position and the municipal budgeting process is unknown at this time.</p> <p>Municipalities currently budget for transfers to reserves based on future capital replacement needs. Budgeting for both transfers to reserves and amortization expense could result in unnecessary tax increases. Maintaining the existing current and capital funds in conjunction with the introduction of the new statement of operations and recording depreciation</p>	<p>X</p> <p>(pending clarification)</p>	

<p>expense in the capital fund could avoid this problem.</p> <p>These issues must be sorted out before PS 3150 is applied to Ontario municipalities. We understand that no firm answers can be provided until PSAB has considered adjustments to the standards of presentation and disclosure for government in PS 1200 and the objectives of financial statements for local Governments in PS 1700 in light of the proposed application of PS 3150 to local government. We understand as well that the Ontario Ministry of Municipal Affairs and Housing will be considering whether legislative amendments are needed to accommodate PS 3150 and related changes. We look forward to being able to contribute to these consultations.</p> <p>Recording tangible capital assets and depreciation in municipal financial statements may impact the way that the provincial and financial grants are awarded and calculated. This may or not be a good thing or a bad thing, but it is something that should be kept in mind.</p> <p>Over and above the actual impact on municipal budgeting and taxation processes, the introduction of accounting for capital assets on an accrual basis will create major communication challenges for municipal staff in presenting budget and financial information, something that PSAB should explicitly address its communications plans.</p>		
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The estimate of the useful life of the remaining unamortized portion of a tangible capital asset should be reviewed on a regular basis and revised when the appropriateness of a change can be clearly demonstrated. [PS 3150.30]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>While it will mean more work for municipalities, the proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our comments on 3150.24</p>	<p>X</p> <p>(in principle)</p>	<p>X</p>

When conditions indicate that a tangible capital asset no longer contributes to a government's ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital asset is less than its net book value, the cost

of the tangible capital asset should be reduced to reflect the decline in the asset's value.  
[PS 3150.32]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>While it will mean more work for municipalities, the proposed rule is in line with generally accepted accounting principles and should work for the local government sector. It is worth noting, however, that because of the unique nature of many local government capital assets, it may be difficult to establish reasonable criteria for determining whether a decline in value has occurred. As well, see our caveats for 3150.24.</p>	<p>X (in principle)</p>	

The net write-down of tangible capital assets should be accounted for as expenses in the statement of operations. [3150.33]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our caveats for PS 3150.24.</p>	<p>X (in principle)</p>	

A write-down should not be reversed. [3150.34]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should, in principle work for the local government sector. However, PSAB may wish to allow for a situation in which a municipal water system, for example, is deemed obsolete because of scientific developments or a change in regulatory policy, but shortly thereafter is found to still have useful life because of new scientific findings or the issuance of new regulations. As well, see our caveats for PS 3150.24.</p>	<p>X (in principle)</p>	



The difference between the net proceeds on disposal of a tangible capital and the net book value of the asset should be accounted as a revenue or expense in the statement of operations. [3150.40]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, see our caveats for PS 3150.24.</p>	X	

The financial statements should disclose, for each major category of tangible capital assets and in total:

- (a) cost at the beginning and end of the period;
- (b) additions in the period;
- (c) disposals in the period;
- (d) the amount of any write-downs in the period;
- (e) the amount of amortization of the costs of tangible capital assets for the period;
- (f) accumulated amortization at the beginning and end of the period; and
- (g) net carrying amount at the beginning and end of the period. [3150.41]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector.</p>	X	

Financial statements should disclose the following information about tangible capital assets:

- (a) the amortization method used, including the amortization period or rate for each major category of tangible capital asset;
- (b) the net book value of tangible capital assets not being amortized because they under construction or development or have been removed from service;
- (c) the nature and amount of contributed tangible capital assets received in the period and recognized in the financial statements;
- (d) the nature and use of tangible capital assets recognized at nominal value;
- (e) the nature of the works of art and historical treasures held by the government; and
- (f) the amount of interest capitalized in the period. [3150.43]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>The proposed rule is in line with generally accepted accounting principles and should work for the local government sector. However, PSAB should consult further with municipalities on complications arising from the implementation of (e).</p>	X	

This Section applies to local governments for fiscal years beginning on or after January 1, 2008. [3150.45]

	<b>Agree</b>	<b>Disagree</b>
<p><b>Reason(s)</b></p> <p>We recommend a longer implementation period (at least one year) to 2009 to ensure local governments have the necessary time to deal with all the practical challenges that local governments will face, including:</p> <ul style="list-style-type: none"> <li>• Uncertainties regarding asset classes, historical/replacement costs, useful life and financial statement presentation</li> <li>• Location of historical records dating back to pre-amalgamation is not known in some cases</li> <li>• Time and resources required to test and implement an Asset Management System for financial reporting.</li> <li>• Concerns regarding auditors' level of testing for compliance, the probability of a qualified audit opinion and the reaction from financial institutions and credit rating agencies if a qualified audit opinion is reported.</li> </ul> <p>Alternatively, phase-in by asset class, starting with water, sewer and waste disposal assets for fiscal year 2008, to be followed by other classes in 2009 should be considered.</p> <p>We note GASB offered state and local governments up to seven years to comply with capital asset reporting provisions of Statement 34.</p> <p>Irrespective of the implementation date, training and additional guidance will be required for councillors, staff and</p>		X



some municipalities received qualified auditor's reports in 2009 that could result in higher borrowing costs and slow the pace of infrastructure renewal.

We note that the introduction of PS 3150 has implications for municipal budgeting and taxation. We understand these cannot be fully assessed until PSAB completes its review of the presentation and disclosure standards for government in PS 1200 and the objectives of financial statements for local governments in PS 1700. The joint MFOA/AMCTO committee has asked to participate in the consultation that PSAB is planning for the fall on these two statements.

We also note that the impact of accounting for tangible capital assets on municipal budgeting and taxation processes goes beyond PSAB's mandate and into the jurisdiction of the Ministry of Municipal Affairs and Housing (for Ontario municipalities). We have confirmed that the Ministry will provide MFOA, AMCTO and other stakeholders an opportunity to help the Ministry work through the practical implications of PS 3150 and devise solutions to any problems identified.

**It is critical that the implications of PS 3150 for municipal budgeting and taxation be known before the policy is implemented. This is an important reason for our recommendation for moving the implementation date to January 1, 2009.**

Subject to these critical concerns being addressed, a majority of the joint MFOA/AMCTO review committee believe that the application of PS 3150 to local government will be beneficial and should proceed.

There was a minority view within the committee that capital asset and depreciation reporting is not appropriate for municipal financial reporting. That view is set out in some detail in the enclosed letter and completed questionnaire from the Finance Department of the City of Mississauga. As you will see, the Mississauga staff support many of the mitigating measures recommended by the larger group (asset categories, useful life guidelines, etc.) in the event that PS 3150 is extended to local government.

We appreciate having had the opportunity to provide input on the issues raised in your July 4 request and look forward to PSAB's forthcoming consultation on the related issues with respect to PS 1200 and PS 1700. Our joint committee will also be providing a response by the September 30 deadline to PSAB's August 9 request for comments on the proposed policy on Government Transfers and Operating and Capital Grant Revenue Recognition.

Please let us know whenever we can be of assistance to PSAB.

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Municipal Finance Officers' Association

Andy Koopmans, CMA  
Executive Director  
Association of Municipal Managers,  
Clerks & Treasurers of Ontario

cc: John Burke, Deputy Minister, Ministry of Municipal Affairs & Housing  
Roger Anderson, President, Association of Municipalities of Ontario