Deloitte.

Tangible Capital Assets

Audit Considerations

Municipal Finance Conference

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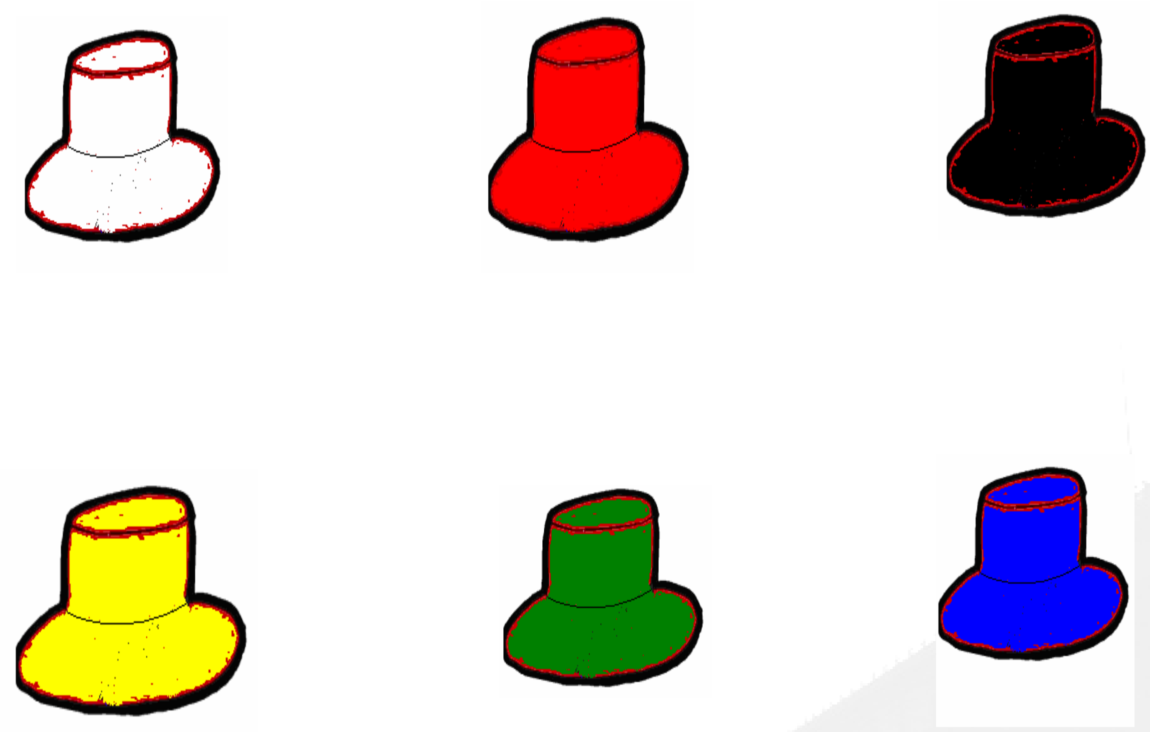
Audit Considerations - Overview

Generally Accepted Accounting Principles (GAAP) → **Implementation Guidance / Plans** → **Policies / Procedures and Controls** → **Generally Accepted Auditing Standards (GAAS)**

Six Thinking Hats*



*Source: Edward De Bono – Six Thinking Hats

PS 3150 – Tangible Capital Assets

Accounting / Presentation

- Account for and report as assets on the statement of financial position
- Record at cost
- Amortize over useful life
- Account for amortization as an expense on the statement of operations
- Review amortization on a regular basis
- Write down when conditions indicate to do so
- Record write down as an expense on the statement of operations
- Write downs should not be reversed
- Account for difference between proceeds and NBV as a revenue or expense on the statement of operations

PS 3150 – Tangible Capital Assets

(continued)

Disclosure

For each major category of assets disclose:

- Cost, at beginning of period
- Additions
- Disposals
- Write downs
- Amortization
- Accumulated Amortization, beginning and end of period
- Net carrying amount beginning and end of period

PS 3150 – Tangible Capital Assets

(continued)

Disclosure

- Amortization method and amortization period by category of assets
- NBV of Tangible Capital Assets (TCAs) not amortized (under construction or development or are removed from service)
- Nature and amount of contributed TCA's received in the period and recognized
- Nature and use of TCAs recognized at nominal value
- Nature of works of art and historical treasures held
- Amount of interest capitalized

PS 3150- Tangible Capital Assets

(continued)

Transitional Provisions for Local Governments

- Applies to local governments for fiscal years beginning on or after January 1, 2009. Earlier adoption is encouraged
- Applies to all tangible capital assets
- PUBLIC SECTOR GUIDELINE PSG-7, Tangible Capital Assets of Local Governments is to be applied during the period of transition – effective January 1, 2007. It provides guidance on information to disclose relative to tangible capital assets
- All government tangible capital assets would be recorded in a government's accounting system

PS 3150 – Tangible Capital Assets

(continued)

Transitional Provisions for Local Governments (continued)

PS 3150.47

“When a government does not have historical cost accounting records for its tangible capital assets, it will need to use other methods to estimate the cost and accumulated amortization of the assets. It may be possible to derive information for recording tangible capital assets from records of government departments that manage those assets. A government would apply a **consistent method of estimating** the cost of the tangible capital assets for which it does not have historical cost records, except in circumstances where it can be demonstrated that a different method would provide a more accurate estimate of the cost of a particular type of tangible capital asset”.

Implementation Issues = Audit Considerations

- What is cost? – preconstruction, direct, allocations, interest capitalization
- Component approach vs. whole asset approach
- Materiality and thresholds for capitalization
- Definitions and policies relating to betterments vs. repairs and maintenance
- Estimating cost - Valuation approach when historical cost unavailable
- Determining asset condition - initially and ongoing
- Assessing an asset’s remaining useful life
- Asset write offs
- Ownership issues
- Completeness and valuation issues for contributed/donated assets

Funding $\neq$ Accounting

Other Relevant PSAB Guidelines

PSG-2

Leased tangible capital assets

This Guideline :

(a) defines leased tangible capital assets;
(b) describes how to account for a leased tangible capital asset and the related lease liability;
(c) describes the information that should be disclosed about transactions involving leased tangible capital assets; and
(d) provides guidance on initial application of the Guideline.

It applies to the summary financial statements of federal, provincial, territorial and **local governments.**

Other Relevant PSAB Guidelines (continued)

PSG-3
Sale-leaseback transactions

This Guideline defines a sale-leaseback transaction and describes how to account for such transactions when the leaseback involves either a leased tangible capital asset or an operating lease.

This Guideline currently applies to the summary financial statements of local governments and will eventually be replaced with “PSG-5 Sale-leaseback transactions – Expense-based” when local governments adopt the new reporting model.

Other Relevant PSAB Guidelines (continued)

PSG-5
Sale-leaseback transactions — expense-based

This Guideline defines a sale-leaseback transaction and describes how to account for such transactions when the leaseback involves either a leased tangible capital asset or an operating lease.

This Guideline applies to the summary financial statements of federal, provincial and territorial governments.

PSG -5 will apply to local governments when they adopt the new reporting model.

Other Relevant PSAB Guidelines (continued)

PSG-7
Tangible capital assets of local governments

The purpose of this Guideline is to provide transitional guidance to a local government on presenting information related to tangible capital assets in notes or schedules to its summary financial statements.

This Guideline applies to fiscal years beginning on or after January 1, 2007. Earlier adoption is encouraged.

Why Change?

Financial statements should

- adhere to a conceptual framework
- be relevant, reliable, comparable and understandable to all stakeholders
- provide meaningful information on financial position and results – greater accountability and transparency
- not be based on funding mechanisms and/or taxation frameworks
- reflect what you own and the cost of using existing capital assets in the provision of services
- provide a basis for asset management and resource allocation decisions
- provide a basis for costing services and assessing affordability of programs

The Public Sector Accounting Conceptual Framework

What is an accounting conceptual framework ?

1100.04

"A conceptual framework for accounting consists of an interrelated and compatible system of objectives, standards or principles, and practices or procedures, all linked rationally to the needs of users …

….since financial statement objectives identify goals and purposes, the qualitative characteristics of financial information, and recognition, measurement, presentation and disclosure standards follow logically from them and provide guidelines for the development of compatible accounting practices".

The Public Sector Accounting Conceptual Framework (continued)

Why do we need a conceptual framework?

- to guide standard setters – provides guidelines and boundaries against which accounting issues being considered can be evaluated
- to provide a basis for financial statement preparers and auditors to apply professional judgment
- to interpret information contained in a financial statement and help address reporting issues when no specific guidance is available (PS 1150)
- to allow the financial statements to meet the needs of the various stakeholders
- to improve confidence in financial reporting

The Public Sector Accounting Conceptual Framework (continued)

Key Components of the Conceptual Framework

- Sets out definitions of the elements of a financial statement – assets, liabilities, revenues and expenses
- Only assets that meet the asset definition and liabilities that meet the liabilities definition are recognized on the statement of financial position
- The conceptual framework defines revenue and expenses (surplus/deficit) in terms of changes in assets and liabilities
- Requires a full accrual basis of accounting to be used
- Provides general recognition and measurement principles

Need for further dialogue and education on the conceptual framework - concerns relating to volatility and the impact on the budgeting process

The New Reporting Model

PSAB has issued an Exposure Draft on the New Reporting Model.

Encompasses three sections:

- Section PS 1000 Financial Statement Concepts
- Section PS 1100 Financial Statement Objectives
- Section PS 1200 Financial Statement Presentation

Collectively these sections are referred to as the "Reporting Model" and are based on full accrual accounting principles.

If approved these sections will replace:

- Section PS 1700 Objectives of Financial Statements – Local Governments
- Section PS 1800 General Standards of Financial Statement Presentation – Local Governments

Components of a Financial Statement Audit

- Obtaining an understanding of the entity and its environment, including **internal control** sufficient to identify and assess the risks of material misstatements of the financial statements, and sufficient to design and perform further audit procedures
- Examining, on a test basis, **evidence** supporting the amounts and disclosures in the financial statements
- Assessing the **accounting principles** used and **significant estimates** made by management, and
- Evaluating the **overall financial statements presentation**

Need to consider the role of the Auditor

Audit Requirements

Remember that your Auditor has requirements for obtaining audit evidence with respect to the initial recording of tangible capital assets as well as in-year transactions and balances.

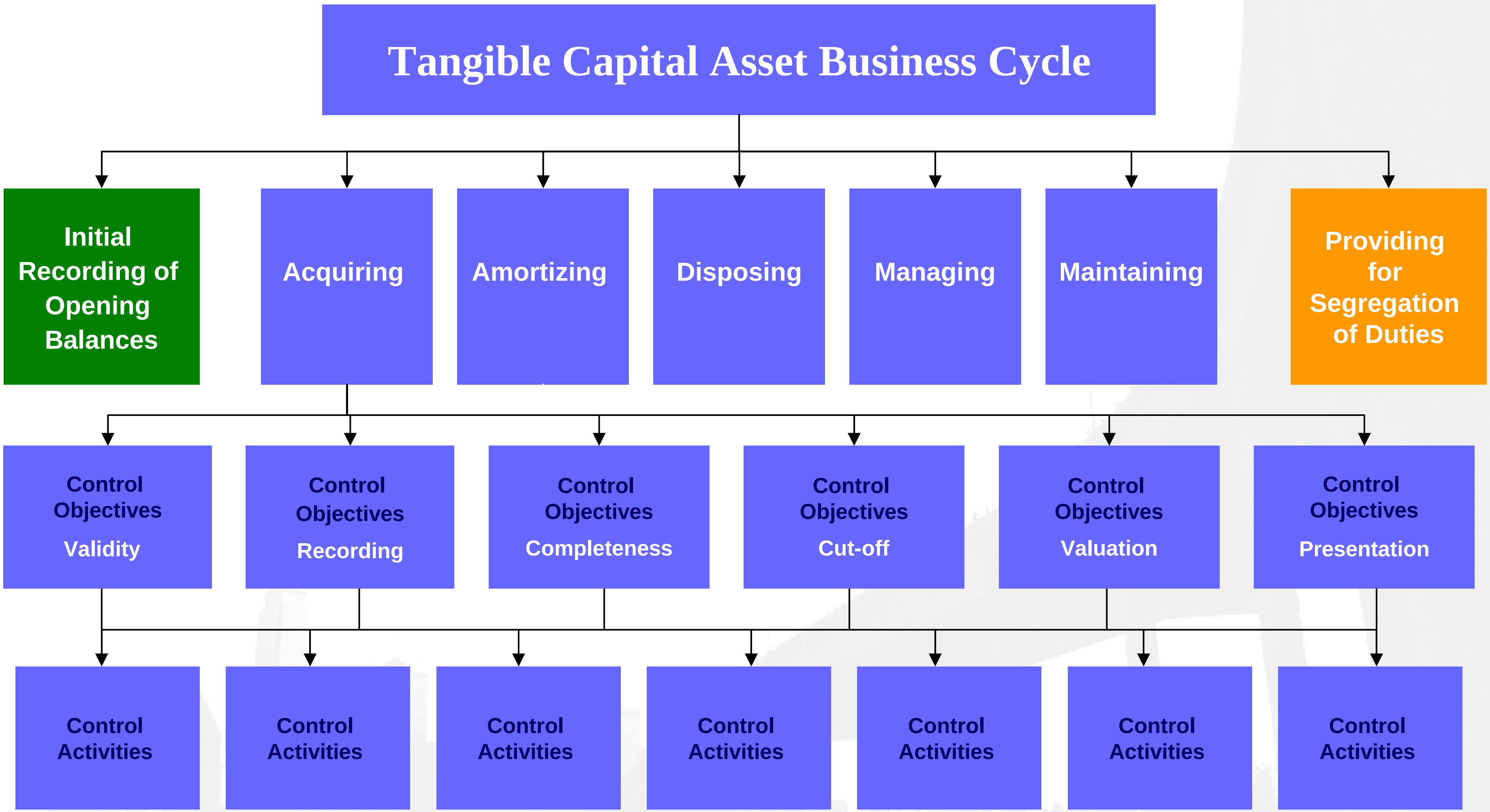
Types of Audit Assertions

- Validity
- Recording
- Completeness
- Cut-off
- Valuation
- Presentation

Types of Audit Evidence

- Inspection of records or documents
- Inspection of tangible assets
- Observation
- Enquiry
- Confirmation
- Recalculation
- Re-performance
- Analytical procedures

Sample of a Business Cycle



Audit Considerations - Initial Recording

EXAMPLES

- Validity & Completeness
  - What are your sources of data?
  - What processes will be used to complete the tangible capital asset inventory?
  - Are these processes documented?
  - Who will perform the inventory?
  - Are you comfortable with the completeness and accuracy of procedures performed and results achieved?
- Recording
  - Interface with general ledger
    - Separate data base versus integrated asset management system
  - Capitalization thresholds

Audit Considerations - Initial Recording (continued)

- Valuation
  - Historical Cost
    - What is cost? Policies
    - What historical cost information is readily available?
    - What additional historical cost information is available (with some effort)?
    - Is this historical cost information reliable?
    - What resources are required/available to complete this task?
  - Alternative valuation methods
    - What other methods are available?
      - discounted reproduction cost / replacement cost
      - Book value calculator
  - Does the valuation methods selected provide independent audit evidence?
    - Independent valuation reports
    - Estimation methodology documented
- Presentation
  - Financial statement disclosures in accordance with GAAP

Audit Considerations - Initial Recording (continued)

Implementation Guidance and Planning

- Learn from the work that is being completed by various organizations OMBI, MFOA/AMCTO, CICA PSAB, etc.
- Communicate with your departments, audit committee and council
- Prepare an implementation plan
- Document processes from ‘cradle to grave’
- Test your ‘cradle to grave’ implementation process on a small segment of the relevant asset categories to experiment with your complete approach
- Meet with your auditor at various stages to discuss your timelines, approach, valuation methods, policies, findings to date, etc.

Internal Control Considerations – In-Year Transactions and Year End Balances

The following is a sample of the types of control activities you may have within a tangible capital asset business cycle once PS 3150 has been implemented.

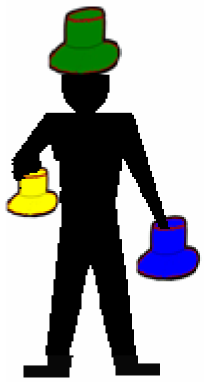
- **Acquiring**
  - Capitalization threshold policies approved and followed
  - Authorization for acquisitions
  - Budget approval checked
- **Disposing**
  - Authorization of disposals
  - Regular asset counts and reconciliation to general ledger
- **Amortization**
  - Depreciation policies approved and followed
  - Independent recalculation
- **Managing**
  - Preparation of and regular updated to asset maintenance schedules
  - Reconciliation of asset maintenance schedules to actual asset maintenance activities and history
  - Regular review by management to ensure asset maintenance activities is accurately maintained
  - Condition of asset assessed periodically
- **Maintaining**
  - Regular review of asset master files by management to ensure accurate and relevant
  - Regular & timely reconciliation to general ledger
  - Independently obtained data to support asset acquisition, asset disposal, and amortization

Independence - ICAO Rule 204

- Auditors must remain independent (need to identify and evaluate threats to independence and ensure safeguards are applied)
- Rule 204 has certain prohibitions with respect to the Auditor's involvement in the preparation of accounting records and financial statements
- Preparation of accounting records and financial statements can result in a self-review threat for the Auditor – "Auditing his or her own work"
- ICAO technical interpretations of Rule 204 provides guidance with respect to the Auditor's ability to provide input on matters such as accounting principles, financial statement disclosures, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities
- Your need for professional services in the implementation of these standards and the scope of the Auditor's involvement should be determined early in the process

PUT ON YOUR HAT AND LETS GET STARTED

Client



Auditor