

Prince Edward Island

Implementation Guide to Tangible Capital Assets for
Municipalities

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1. Background

The Public Sector Accounting Board (PSAB) presents Canadian municipalities with significant changes to accounting for tangible capital assets. For fiscal years beginning on or after January 1, 2009, PS3150 will require municipalities to start capitalizing their tangible capital assets (TCA) and to allocate their costs to future accounting periods through an annual amortization expense. Since Prince Edward Island Municipalities fiscal year runs January 1st to December 31st, this guide covers what will be required for the initial asset valuation for January 1, 2009, and then looks at the ongoing requirements to maintain tangible capital assets accounts after January 1, 2009.

Compliance with PS3150 will require municipalities to change their processes for reporting, budgeting and day-to-day accounting for tangible capital assets. This guide has been developed to inform municipalities what is required to comply with the new standards. This guide is not, however, intended to be the final authoritative source for tangible capital assets. Municipalities are encouraged to become familiar with the PS 3150 recommendations and review compliance considerations with their auditors.

2. PSAB Rules on Tangible Capital Assets

Tangible capital assets (TCA) are a significant economic resource of municipalities and a key component in the delivery of many municipal government programs. The Public Sector Accounting Board (PSAB) has issued new standards that will come into effect for fiscal years starting January 1, 2009.

2.1 PSAB requirements

As of January 1, 2009, PSAB will require that local governments record their TCA on the statement of financial position (i.e. balance sheet) and amortize them over their useful life. The current policy for accounting for TCA provided municipalities with the following options:

- Expensing the TCA in the Revenue fund as contributions to the capital fund.
- Recording the TCA as fixed assets in the capital fund while not recording any amortization.

Current financial statements do not provide any information about the nature and age of a municipality's TCA. This information is useful when forecasting maintenance and replacement requirements of a municipality's TCA and should be available to financial statement users.

2.2 Consult with Auditors

It is recommended that your auditors be consulted regarding PS 3150 requirements as soon as possible. As your auditors will be asked to sign off on your December 31, 2009 financial statements, it is ideal that they be consulted during the process of valuing your assets to avoid problems in the future.

Before consulting with your auditors, it is recommended that you compile an asset listing in order to efficiently deal with issues associated with asset valuation. By discussing issues early in the process, you will be aware of what is required for the auditors to issue an unqualified audit opinion.

To be comfortable with the figures presented, your auditors will want to know that:

- You have a complete listing of all of the municipality's tangible capital assets;
- You have valued your assets on a consistent basis, using historical cost wherever possible;
- You have reasonably assessed the useful life and current condition of each asset;
- You have adopted a consistent and reasonable amortization basis for each type of asset;
- You have chosen realistic capitalization thresholds;

- You have not excluded any assets that have a material value; and
- You have appropriate back-up documentation to support all figures used for valuation and for amortization.

2.3 Definition of TCA

The Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting Handbook (PS 3150.05) defines TCA as non-financial assets having physical substance that:

- i) Are used in the production or supply of goods and services;
- ii) Have useful economic lives extending beyond one year;
- iii) Are to be used on a continuing basis; and
- iv) Are not for sale in the ordinary course of operations.

TCA includes:

TCA include such diverse items as equipment, office equipment, computers, computer software, motor vehicles, buildings, land, sidewalks, signs, bridges and water and sewer systems.

TCA does not include:

TCA does not include intangible assets, natural resources, and Crown lands that have not been purchased by the municipality.

TCA also does not include land held for resale.

Works of art and historical treasures are not recognized as TCA, and include the following:

- Library collections
- Museum collections
- Paintings and sculptures
- Statues, monuments and plaques
- Antiques
- Arts and crafts
- Historic buildings which are not being used to provide municipal services.

Many buildings owned by municipalities have been designated as heritage sites. These buildings are often still being used as municipal office space and are recognized as TCA. Heritage buildings that are being used as museums to display museum collections are also considered TCA.

3. Identify your Tangible Capital Assets

There are 5 critical questions to consider when preparing your TCA listing:

- 1) What TCA do we own and where are they located?
- 2) What is TCAs useful life?
- 3) When did we get the TCA?
- 4) What TCA do we need to capitalize?
- 5) How much did the TCA cost?

Section 3 will deal with the first four questions. The 5th question will be dealt with in Section 4.

3.1 What TCA do we own and where are they located?

Every municipality should prepare a complete listing of their TCA as at December 31, 2008. Beyond visual inspection, the following sources of information could assist in ensuring that your listing is complete:

Land & buildings	-	tax assessment rolls
Buildings & equipment	-	insurance policies
Vehicles	-	insurance policies, registration renewals
Network systems	-	detailed engineering maps

Analysis of the Capital Funds:

Every municipality should perform an analysis of their capital funds to identify possible TCA. This is a relatively simple way of identifying possible assets and information about the asset's cost. However, simply reviewing the general ledger detail of the capital funds will not ensure that your TCA listing is complete or that all entries identified are valid TCA.

Not all assets recorded in the capital funds qualify as TCA. Major repairs and maintenance projects are recorded in the capital fund, but are not necessarily TCA. The nature of the expenditure must be evaluated to determine if it qualifies for capitalization.

A TCA listing should include:

- A description of the asset/class;
- Year of acquisition or reconstruction;

- Expected useful life at the time of acquisition;
- Significant improvements made to the TCA since acquisition and the useful life and date of acquisition of the improvement; and
- Estimated residual value, if any, on disposal.

Asset Classes

An asset class is a group of TCA that are similar in nature and useful life and is likely to have the same valuation and identification. Asset classes vary from small office equipment to large assets like land and buildings. Also, assets can be classified by type of infrastructure such as transportation network and sewer system.

Appendix A lists the various asset classes that a municipality may have and need to record.

3.2 What is the TCAs useful life?

The straight-line method is the simplest method for municipal accounting purpose and should be applicable to most TCA categories. Alternative approaches can be applied to individual asset categories if necessary, but should be evaluated on a case-by-case basis.

With regard to useful lives, the following table by class was developed on a review across Canada. Where a range is listed, it is recommended that a useful life range be selected for the useful life of that asset type. It should be mentioned that you should be consulting with your auditors as they will have to sign off on your financial statements and will have to agree with your methodology in determining your useful life for your assets. For those municipalities whose water and sewer utilities report to the Island Regulatory and Appeals Commission (IRAC), it is recommended they follow IRAC approved amortization rates for their assets.

Asset Type	Useful Life Ranges
Land	Indefinite
Land Improvements	20 - 25 Years
Municipal Buildings	40 Years
Buildings - Plants	20 - 25 Years
Electronic Data Equipment	3 - 5 Years
Small Equipment	5 years
Machinery and Equipment	10 - 15 Years
Vehicles	5 Years
Streets, Sidewalks & Curbs	25 - 30 Years
Traffic & Street Lights	25 - 30 Years
Sewer & Water Lines	50 Years
Storm Sewer Lines	50 Years
Lagoons	50 Years
Fibre Optic Lines	5 - 10 Years
Landfill *	See PSAB 3270
Work in Progress**	Not Applicable

* Landfills should be amortized as per PS 3270, which recommends the operating life of the site be based on volume.

** Work in Progress is not amortized until the asset is complete at which time it will move into a category listed above.

The estimate of the useful life of the remaining unamortized portion of a TCA should be reviewed on a regular basis, and revised when a change is appropriate. The following conditions indicate that a decrease in the useful life of an asset is warranted include:

- physical damage;
- technological developments; and
- change in the extent that an asset is to be used.

A change in the useful life of an asset is a change in an accounting estimate and not a change in an accounting policy, therefore, financial statements of previous years are not required to be restated.

3.3 When did we get the TCA?

It may not always be possible to remember the year of acquisition. However, the acquisition date can be determined by searching in general ledger detail for the entry that was made to initially record the TCA. It is also important to remember that if an asset is well beyond its useful life, it is not necessary to determine its acquisition date.

3.4 What TCA do we need to capitalize?

Capitalization threshold:

A capitalization threshold is the minimum dollar amount that a government will use in determining whether expenditure should be capitalized as a TCA addition or expensed in the current year.

Materiality:

Materiality is a concept frequently used by auditors. A misstatement is considered “material” if a user of the financial statements would likely make a different decision based on the incorrect information than if it were based on the correct information. If a misstatement has significant consequences then the materiality level should be set low. However it may be impractical and prohibitively expensive to set too low a materiality level.

What is an Appropriate Capitalization Threshold?

An appropriate capitalization threshold is a balance between the accurate presentation of the financial statements and the cost of acquiring and maintaining the TCA accounting records. If a municipality sets their capitalization thresholds too high the financial statements will be materially misstated. If the threshold is set too low, the effort to record and maintain the TCA accounting records could be too costly. For example, it would be impractical for a municipality to record and depreciate every stapler that it owns, though by definition a stapler is a TCA.

The capitalization thresholds that you will use to record your initial TCA should also be used for future asset additions and thresholds/significant improvements.

Infrastructure – Single Asset vs. the Component Approach

Infrastructure networks are made up of many components. A water supply system is made up of a network of underground water lines. But it is also made up of tanks, pumps, generators, filtration systems, water treatment systems and meters.

How a municipality accounts for its infrastructure assets will affect the following:

- i) What it considers to be a capital replacement versus maintenance and repairs, and
- ii) The municipality's future amortization expense.

The decision to account for each component as a separate asset should be determined by the usefulness of the resulting information to the municipality, versus the benefit of collecting and maintaining the information.

It is easier to do the accounting of TCA under the single asset method. For example, a water pump house and equipment contained in it can be treated as a single asset and amortized over the useful life of the building. Whereas, under the component approach, which provides better information for the management of TCA, each piece of equipment such as pumps, valves and storage tanks would be separated from the overall cost and amortized over their individual useful lives.

What approach should municipalities use?

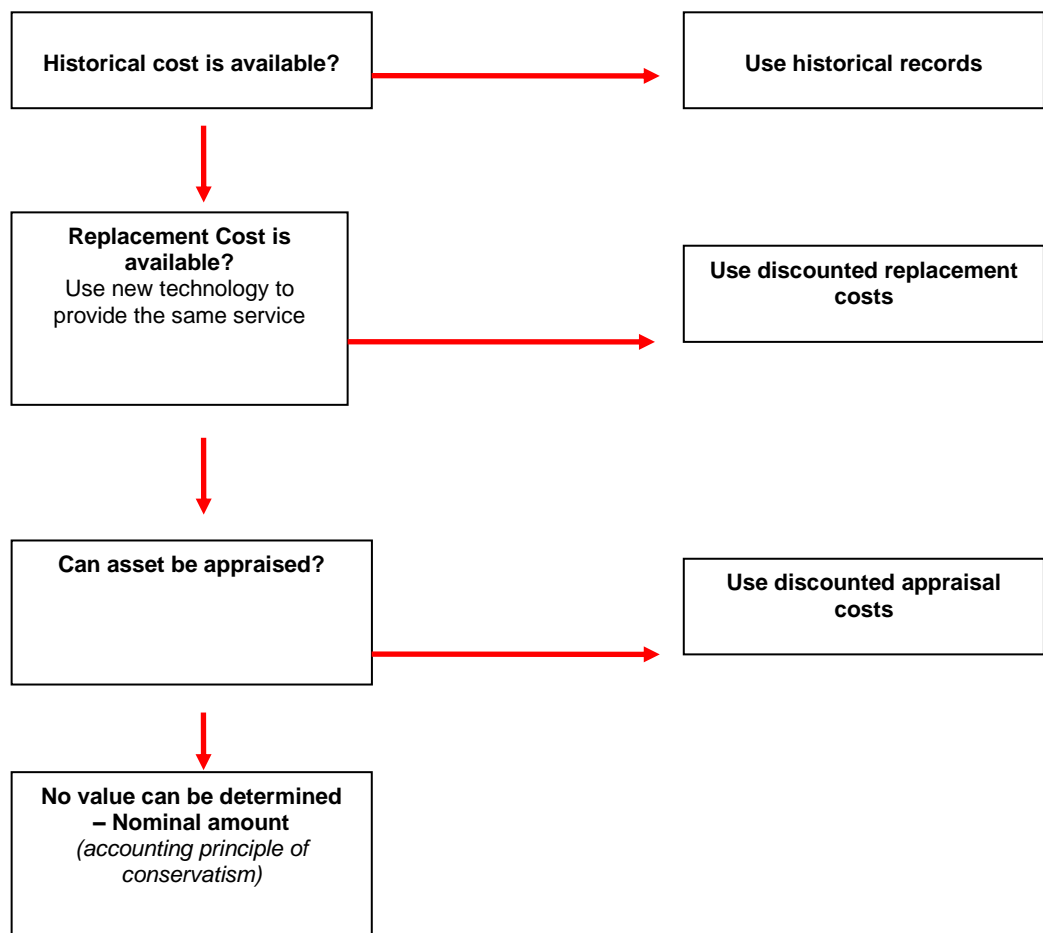
The single asset and component approach are both acceptable under PSAB. The PSAB prefers the component approach but municipalities may choose what is most appropriate for them. It is recommended that municipalities use the component approach to the extent reasonably possible.

4. Determining the value of assets

There are five methods that can be used in determining assets values:

- 1) historical costs
- 2) deflated reproduction costs
- 3) deflated replacement costs
- 4) deflated appraisal costs
- 5) deflated insurance costs

Ontario Municipal Benchmarking Initiative (OMBI) has created a valuation decision tree to guide municipalities in the process of completing the initial valuation of their capital assets.



4.1 Historical cost

Historical cost is the most appropriate method to value Tangible Capital Assets because it is the most objective. Historical cost evaluation requires municipalities to examine past financial records; to the extent they exist, in an attempt to match the financial records with their Tangible Capital Asset listing.

With your linear assets such as sidewalks and sewer lines, a good source would be your Statement of Capital Financing. This report under the old method of filing your financial statements will tell you how much you spent by category. If you have the records going back as far as you need, historic cost for these types of assets can be identified.

4.2 Deflated reproduction costs

Reproduction cost is today's cost to reproduce the asset in the same form with the same materials design and technology, then deflate it back to the year of acquisition.

4.3 Deflated replacement costs

Replacement cost is today's cost to replace the asset, but in a different physical form but same production capacity / same or similar level of service then deflated back to the year of acquisition. The odds are these assets are quite a bit older and this is the most commonly used method if historic costs are not available due to the changes in technology.

4.4 Deflated appraisal costs

This method can be used to determine a value for land and buildings if historic costs are not known, then deflated back to the year of acquisition.

4.5 Deflated insurance costs

An alternative to using an appraiser would be to use your insurance replacement values for today's values, depending on when you had your insurance values reviewed, and deflate back to year of acquisition. It should be noted that you should talk to your auditors before using your insurance values.

5. Deflation rates

There are various sources that can be used to deflate costs back to the year of acquisition. Listed here are two that can be used, (although a municipality can use any index it chooses):

- 1) Consumer Price Index; and
- 2) Southam Construction Price Index.

It should be noted that municipalities must keep copies of all their supporting documentation and calculations for the costing of their TCA, as the auditors will need this information to verify the opening TCA balances.

5.1 Consumer Price Index

The Consumer Price Index is readily available and easily understood. An inflation calculator can be found at http://www.bankofcanada.ca/en/rates/inflation_calc.html and can be used to deflate a cost as well. You cannot go wrong using CPI for deflating present day values back to the year of acquisition.

5.2 Southam Construction Price Index

The SCPI can be used to discount the cost of construction of buildings for any one-year to arrive at a reasonable estimate of the construction costs for any given year before that. The SCPI can be used to discount the cost of buildings. The SCPI is found on Appendix A.

Please note that this is a sample index that can be used and is by no means meant to be the only index that can be used.

6. Other Tangible Capital Assets Issues

There are several other assets and asset costs that require special consideration under the new PS 3150 requirements:

1. Initial recognition of a Tangible Capital Asset
2. Capital lease assets
3. Donated or contributed assets
4. Overhead costs
5. Interest costs
6. Betterment charges
7. Disposals

6.1 Recognition of a Tangible Capital Asset

Under PSAB 3150 a Tangible Capital Asset should be capitalized and amortized when:

- it is 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;
- it has a useful life of more than one accounting period;
- it is to be used on a continuing basis; and
- it is not held for sale in the ordinary course of operations.

Example 1:

A municipality purchased a fire truck for \$200,000 that will be used by the fire department over the truck's useful life of 5 years. The municipality paid for the entire purchase with a bank loan. The entry would be as follows:

Dr. Fire trucks	\$200,000	
Cr. Long-term debt		\$200,000

6.2 Capital lease assets

Under PSAB 3150, capital leases are considered TCAs. PSAB uses a “benefits and risks” approach to assessing if a leased asset should be treated as a capital lease. If the “benefits and risks” of the asset are essentially transferred to the municipality (the lessee) then the lease is a capital lease and the leased asset is a TCA.

The value of the leased TCA and the amount of the lease liability, recorded at the beginning of the lease term, is the present value of the minimum lease payments (PVMLP) excluding executory costs. Executory costs are operating costs related to the operation of the leased asset such as insurance, maintenance, and property taxes. The amount relating to executory costs should be estimated if not known by the municipality.

The maximum value recorded for the asset may not exceed the fair market value (FMV) of the leased property. The value recorded for the asset is also the value of the lease obligation less any down payments or trade-ins.

The rate used to discount the lease payments to the fair market value of the asset is the interest rate implicit in the lease. The fair market value of the asset and the interest rate implicit in the lease are often disclosed together in the lease contract.

6.3 Donated assets and contributions

PS 3150 requires that any asset donated, contributed or transferred to a municipality is to be valued at its fair value at the date of contribution, where that value can be determined using market or appraisal values. If a fair value cannot be determined, the asset is to be recognized as having a nominal value (\$1.00).

Capital grants received from governments cannot be netted against the cost of the asset. They must be recorded as capital contributions and amortized at the same rate as the associated asset for which the grant was received. The cost of the asset must be shown at the gross amount.

Municipalities’ capital projects are normally cost-shared between the municipality and the Province. The portion paid by the Province must be recorded as a capital contribution.

Example 1:

A municipality has received infrastructure funding to extend its sewer lines. The total cost of the project was \$3,000,000 with \$1,000,000 coming from each of the Federal and Provincial governments. The remaining \$1,000,000 was funded with a bank loan. The entry would be as follows:

Dr Sewer Lines	\$3,000,000	
Cr Long-term Debt		\$1,000,000
Cr Capital Contributions – Sewer Lines		\$2,000,000

Example 2:

A municipality spent \$200,000 to re-pave sidewalks as part of its sustainability plan. \$50,000 of the funding of this purchase came from the gas tax reserve funds while the remaining \$150,000 was funded with a bank loan. The entry would be as follows:

Dr Sidewalks	\$200,000	
Cr Long-term debt		\$150,000
Cr Restricted cash – Gas Tax Bank Account		\$ 50,000
Dr Deferred Revenue – Gas Tax Funding	\$ 50,000	
Cr Capital Contributions – Sidewalks		\$ 50,000

6.4 Overhead costs

Overhead costs that may be capitalized per PS 3150 include all amounts directly attributable (e.g. construction, architectural and other professional fees) to the capital asset’s acquisition, construction or development. Carrying costs such as internal design, inspection, administrative and other similar directly attributable costs may also be capitalized. Capitalization of general administrative costs is not permitted.

One exception is when money is spent to conduct an environmental assessment or feasibility study for a planned facility. If and only if construction proceeds and the facility is completed and becomes operational (the facility itself becomes the tangible capital asset) then the cost of environmental studies is directly attributable costs and should be capitalized.

6.5 Interest costs

PS 3150 allows interest costs directly attributable to the acquisition, construction or development of a TCA to be capitalized. If a loan with a floating interest rate is used to finance the up-front costs of a TCA being acquired over a period of time, the costs involved with that financing and directly attributed to the asset can be capitalized, but only until the point in time when the asset is capitalized. Once the asset is put into use, capitalization of carrying costs ceases and such costs become a financing charge and are expensed on the Statement of Financial Activities.

6.6 Betterment charges

During the lifetime of an asset, some major work may be carried out on the asset that will involve a significant expense. Currently, there seems to be some latitude as to whether this type of work is recorded as a capital expense or as repairs and maintenance.

Definition of betterment: Betterments increase the service potential (i.e. capacity), reduce the operating cost or extend the original useful life of a TCA. The costs of betterments are considered to be capital asset additions to the related asset. Betterments are recorded as separate asset additions and amortized over their useful life.

Definition of repairs and maintenance: Maintenance and repairs maintain the service potential of a TCA over its given useful life. Maintenance and repairs are an expense of the period and are not capitalized.

How to decide:

If the work carried out on the TCA only maintains its predetermined service potential and its given useful life, whatever is done is in the nature of maintenance or repairs is to be expensed as incurred.

Work is deemed to be a betterment or an enhancement and can be capitalized if it results in one of the following:

- Increase in physical output
- Increase in service capacity
- Associated operating costs are lowered
- Quality of output is improved
- Useful life is extended

Examples:

Replaced a building's old windows with energy efficient windows (**betterment** – lower operating costs)

Replaced the old air conditioning unit with a similar one (**R&M**)

Paved a gravel sidewalk (**betterment** – service capacity)

Put new gravel on gravel sidewalks (**R&M**)

Extended the water main system to a new subdivision (**betterment** – service capacity)

Replaced a broken water main (**R&M**)

6.7 Disposals

The disposal of an asset removes the historical cost from the total gross cost of tangible assets, along with the asset's accumulated amortization, from the total accumulated amortization recorded. The amount required to balance the entry should be accounted for as a revenue or expense in the statement of operations. The asset record should be removed from your active asset inventory and archived, noting the date and manner of disposal.

Example 1:

On July 31, 2005, a municipality purchased a vehicle for \$35,000 and received a government grant of \$10,000 to be allocated to the purchase. The municipality determined that the vehicle had a useful life of 10 years with a residual value of \$1,500. On July 31, 2008 the municipality decided to sell the vehicle for \$20,000.

The Net Book Value of the vehicle at July 31, 2008 was \$24,950
 $\$35,000 - \$10,050 = \$24,950$
 $(\$35,000 - \$1,500) / 10 \times 3 \text{ yrs} = \$10,050$

The Net Book Value of the government grant at July 31, 2008 was \$7,000
 $\$10,000 - \$3,000 = \$7,000$
 $\$10,000 / 10 \times 3 \text{ yrs} = \$3,000$

The loss on the sale of the vehicle would be \$4,950
 $\$24,950 - \$20,000 = \$4,950$

The entry to record the disposal would be:

Dr Cash	\$20,000	
Dr Accumulated Depreciation – Vehicles	\$10,050	
Dr Capital Contributions	\$10,000	
Dr Loss On Sale Of Asset	\$ 4,950	
Cr Vehicles		\$35,000
Cr Accumulated Amortization – Capital Contributions		\$ 3,000
Cr Grant Revenue		\$ 7,000

7. Amortization

Tangible Capital Assets are used to provide services to the public. Amortization of capital assets treats the effective utilization and reduction in value of a capital asset during the course of a year's operations as an expense of that period. This indicates writing off the cost of the capital asset over its expected life span. Municipalities will be required to record this as an expense starting in 2009. This will also have to be calculated for existing assets to obtain a net book value that takes into account the usage of the TCA to date.

Sample journal entries on how to record the amortization expense for each method are shown below.

7.1 Amortization methods

This section examines the three recommended methods and three related issues:

1. Straight-line amortization.
2. Usage based amortization.
3. Declining-balance amortization.
4. Will it have any residual value?
5. How do you handle write-downs?
6. How do I set up opening balances?

The amortization of the remaining unamortized portion of a TCA should be reviewed on a regular basis and revised when a change is appropriate. The useful lives of assets are normally adjusted downward, but they can be increased. Conditions that indicate that a decrease in the useful life of an asset is warranted include:

- physical damage;
- technological developments; and
- change in the extent that an asset is to be used.

A change in the useful life of an asset is a change in an estimate and not a change in an accounting policy, therefore, financial statements of previous years do not have to be restated.

In the year an asset is purchased, municipalities have the following options regarding the amount of amortization to record:

- Full year of amortization;
- Half-year of amortization;
- Amortization prorated for the number of months the asset was owned during the year; and
- No amortization.

Municipalities are permitted to use any of the above methods as long as the difference between method chosen and amount that would have been recorded for the full year is not material.

7.2 Straight-line amortization

Straight-line amortization assumes an asset's value deteriorates at a constant rate over its useful life. It is the easiest method to understand and apply. It will also result in recognizing the amortization expense evenly over the expected useful life of the asset.

Example:

A municipality purchases a piece of equipment for \$50,000. The equipment is estimated to have a useful life of 10 years. After 10 years, the equipment is estimated to have a residual value of \$3,000. The annual amortization charge is:

$$(\$50,000 - \$3,000)/10 \text{ yrs} = \$4,700 \text{ annual amortization charge.}$$

The entry into the general ledger would be:

Dr. Amortization Expense	\$4,700	
Cr. Accumulated Amortization – Equipment		\$4,700

7.3 Usage based amortization

There are Tangible Capital Assets where the straight-line method is not the most appropriate amortization method. Some assets are guaranteed for so many hours of service, or to handle a specific volume of units. This method assumes that an asset deteriorates on the basis of usage or of hours of service. This method requires that the upset limit be specified up front, and that the monthly or annual usage be accurately measured and logged.

7.4 Declining balance amortization

Some assets deteriorate or lose value rapidly at the beginning of their lives, and then the rate of deterioration slows down towards the end, for example automobiles and other vehicles.

7.5 Residual value

An issue to consider when calculating amortization is whether an asset will have a residual value when it is disposed. If the asset is sold, the amortization expense would ideally account for only the buy/sell price spread rather than the total cost. However, municipalities typically use their assets over their useful lives, resulting in the assets being of minimal value at the end of their useful lives. It is suggested that residual value be deemed to be zero when calculating the amortization expense for any asset. Although the PSAB guidelines talk about allowing for residual values, deeming them to be zero is less likely to result in asset values being overstated and annual amortization expense being understated.

7.6 Write-downs

A Tangible Capital Asset's value should be written down if the asset:

- has become redundant;
- is unable to contribute to providing goods or services; and
- no longer has a future economic benefit greater than its net book value.

If any of the above conditions exist, the asset should be written down to reflect the decline in value. This net write-down is to be accounted for as an expense in the Statement of Operations. In the case of a redundant asset, the write-down will be to its anticipated residual or resale value, if any. Write-downs should only be recorded when the decline in the asset's value is expected to be permanent.

PS 3150.34 gives conditions that indicate where a write-down is appropriate, as follows:

1. a change in the extent that the TCA is used;
2. a change in the manner in which the TCA is used;
3. significant technological developments;
4. physical damage;
5. removal of the TCA from service;
6. a decline in, or cessation of, the need for the services provided by the TCA;
7. a decision to halt construction of the TCA before it is complete or in usable or saleable condition; and
8. a change in the law or environment affecting the extent that the TCA can be used.

The persistence of such conditions over several successive years increases the probability that a write-down is required. **Note that a write-down is never reversed.**

Example:

A municipality constructed a playground for children located along a river. The cost of the development was \$10,000 and the playground opened to the public on June 1, 2002. The useful life of the playground equipment was determined to be 10 years, with no residual value. In the summer of 2006, severe flooding occurred and damaged the playground to the point that it was no longer safe to be used.

The Net Book Value of the playground equipment June 1, 2006 would be \$6,000

$$\$10,000 - \$4,000 = \$6,000$$

$$\$10,000/10 \times 4 \text{ yrs} = \$4,000$$

The entry to record the write-down would be:

Dr. Accumulated Depreciation – Playground Equipment	\$ 4,000	
Dr. Loss On Write-down Of Asset	\$ 6,000	
Cr. Playground Equipment		\$10,000

7.7 Setting up opening balances

After you have listed and valued all your Tangible Capital Assets, you must:

- i) Calculate the accumulated amortization to December 31, 2008, for each asset category;
- ii) Track additions and disposals for the year ended December 31, 2009;
- iii) Calculate the amortization expense for the year ended December 31, 2009, for each asset category;
- iv) Enter the opening Tangible Capital Assets balances into your accounting records as of January 1, 2009; and
- v) Calculate the amortization expense for the year ended December 31, 2009 into your GL accounts.

Calculating the accumulated amortization to December 31, 2009:

For each asset category, you must calculate the accumulated amortization to December 31, 2008.

Example:

A municipality's owns a building that was put into use on January 1, 1995. The municipality calculated the discounted reproduction cost to be \$250,000. It was determined that the building had a useful life of 40 years and is going to be amortized on straight line basis.

The annual amortization charge would be \$6,250

$$\$250,000/40 \text{ years} = \$6,250$$

The accumulated amortization at December 31, 2009 would be \$81,250

$$\$6,250 \times 13 \text{ yrs} = \$81,250$$

Calculate the amortization expense for the year ending December 31, 2008:

For each asset category, you must calculate the amortization expense for the year ended December 31, 2008. Do not record the 2008 amortization expense into your 2008 GL. The December 31, 2008 cost and accumulated balances by class are very important. These are the numbers that you will enter into your GL records at January 1, 2009.

Example (cont'd):

The amortization expense for the building in 2009 was \$6,250
 $\$250,000/40 = \$6,250$

The accumulated amortization for the building at December 31, 2008 would be \$87,500
 $\$81,250$ at December 31, 2008 + \$6,250 for 2009

The Net Book Value of the building at December 31, 2008 would be \$162,500
 $\$250,000 - \$87,500$

Enter Tangible Capital Assets balances at January 1, 2009 into GL:

Before you can enter the Tangible Capital Assets balances at January 1, 2009 into your GL, you must first:

- 1) Reverse or in effect eliminate your current "Fixed Asset" balances in your GL;
- 2) Create a "cost" account for each Tangible Capital Assets asset class that your municipality owns;
- 3) Except for land, create an "accumulated amortization" account for each "cost" account or asset class; and
- 4) Create an "amortization expense" account for each ledger (general and utility) that your municipality uses.

8. Note disclosure requirement

Example:

THE WORDING CONTAINED IN THE FOLLOWING NOTE IN ITALICS SHOULD BE TAILORED TO THE INDIVIDUAL MUNICIPALITY DEPENDING ON ITS PARTICULAR CIRCUMSTANCES. IN SOME CASES IT SHOULD BE OMITTED ENTIRELY IF NOT APPLICABLE.

1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of [Insert name] ("The Municipality") are prepared by management in accordance with Canadian generally accepted accounting principles for local governments established by the Public Sector Accounting Board ("PSAB") of the Canadian Institute of Chartered Accountants ("CICA").

x) Physical Assets

i) Tangible Capital Assets

Effective January 1, 2007, The Municipality adopted Accounting Guideline 7 (PSG-7) of the Public Sector Accounting Handbook of the Canadian Institute of Chartered Accountants ("CICA") with respect to the disclosure of Tangible Capital Assets of local governments. PSG-7 provides transitional guidance on presenting information related to Tangible Capital Assets until Section 3150 - Tangible Capital Assets of the Public Sector Accounting Handbook comes into effect on January 1, 2009.

[Prior to January 1, 2007, The Municipality previously recorded Tangible Capital Assets including assets held under capital leases at cost in the period they were acquired on the statement of financial position and as an expenditure within the capital fund. Certain capital assets in the [...list names of business units or entities...] were amortized on a [identify basis – i.e. straight-line basis] over their estimated useful lives... [or indicate that assets were not previously amortized].]

During the current fiscal year, The Municipality continued to work towards compliance with the new recommendations for accounting for Tangible Capital Assets. As of December 31, 2008, The Municipality... *[provide a status update][....had obtained a complete listing and values for [...identify asset classes i.e. all land, buildings, engineered structures, machinery and equipment and vehicles...]. A complete listing of assets and values for the [...identify asset classes for which listing are not yet completed...] is currently underway and expected to be completed by December 31, 2009].*

As of January 1, 2007, capital assets including assets held under capital leases are recorded at cost in the period they are acquired and recorded as an expenditure within the capital fund. Donated assets related to wastewater distribution and collection systems are capitalized and are recorded at their estimated fair value upon acquisition. Works of art for display in municipal property are not included as capital assets. Certain capital assets for which historical cost information is not available has been recorded at current fair market value discounted by a relevant inflation factor.

The Municipality does (or does not) capitalize interest as part of the costs of its capital assets. Certain assets such as *[...list assets...]* are disclosed at a nominal value as the determination of a fair market value for these types of assets is not appropriate.

As of January 1, 2007, amortization for *[...identify asset classes...]* is presented in the notes to the financial statements. Amortization is not recorded as an expense. Amortization for the *[...identify asset classes...]* classes are expected to be presented in the *[...identify year...]* financial statements and is calculated on a *[...identify basis – i.e. straight-line basis...]* over an asset's estimated useful lives as follows:

	YEARS
Land Improvements	
Buildings	xx-xx
Engineered structures	
Wastewater system	xx-xx
Storm system	xx-xx
Fibre optics lines	xx-xx
Electricity system	xx-xx
Machinery & Equipment	xx-xx
Vehicles	xx-xx

XX. TANGIBLE CAPITAL ASSETS

	2009			2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	\$xx	\$ -	\$ xxx	\$ -	\$ -	\$ xxx
Buildings	xxx	xxx	xxx	xxx	xxx	xxx
Furniture & Fixtures	xxx	xxx	xxx	xxx	xxx	xxx
Machinery & Equipment	xxx	xxx	xxx	xxx	xxx	xxx
Computer Equipment	xxx	xxx	xxx	xxx	xxx	xxx

A Municipality would use the 2007 table below if they had any values recorded for Tangible Capital Assets in their financial statements in prior years. If not, they would just show the 2008 table above with an opening cost at the beginning of the year of nil for each of the asset classes.

	2008			2007		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	\$xx	\$ -	\$ xxx	\$ -	\$ -	\$ xxx
Buildings	xxx	xxx	xxx	xxx	xxx	xxx
Furniture & Fixtures	xxx	xxx	xxx	xxx	xxx	xxx
Machinery & Equipment	xxx	xxx	xxx	xxx	xxx	xxx
Computer Equipment	xxx	xxx	xxx	xxx	xxx	xxx

Amortization of assets in the amount of \$185,000 (2007 – \$120,000) has been recorded [*indicate how recorded in the Municipality’s financial statements*], and amortization related to total donated assets of \$xxx,xxx (2007 - \$xx,xxx) in the amount of \$xx,xxx (2007 - \$xx,xxx) has been recorded as a reduction to equity in physical assets. Capital assets included in work in progress are not amortized. The Municipality’s assets include \$xx,xxx (2007 – \$xx,xxx) in assets which are not being amortized as they have been removed from service.

Glossary of terms

Accumulated amortization:

Accumulated amortization is the total of amortization charges to date on a tangible capital asset or group of tangible capital assets.

Amortization:

Amortization is a systematic and logical process of recognizing the expense associated with using a tangible capital asset during a fiscal period. Amortization is often thought of as “depreciation”.

Asset class:

An asset class is a grouping of tangible capital assets that are similar in nature and useful life. “Buildings” is an example of an asset class. Asset classes form the basis for the general ledger accounts and the summary presentation of tangible capital assets by major groupings in the financial statements.

Betterment:

A betterment is a cost incurred that either increases the capacity, extends the useful life or reduces the operating costs of a tangible capital asset.

Capital lease:

A capital lease is a lease with terms and conditions that substantially transfers all the “benefits and risks” of ownership to the lessee (i.e. the municipality), without necessarily transferring legal ownership.

Capitalization:

Capitalization is the process of recording an eligible expenditure as a tangible capital asset, or including it as part of the cost of a tangible capital asset.

Capitalization threshold:

The capitalization threshold is minimum dollar amount that government will use in determining whether an expenditure should be capitalized as a tangible capital asset addition or expensed in the current year.

Capitalized interest:

Capitalized interest is the interest and carrying charges owed on the debt to external parties that is included as part of the cost. Only interest that is directly attributable to the development and construction of a tangible capital asset can be capitalized. The capitalization of interest ends when the asset is put into use or construction completed.

Component:

A component is a tangible capital asset that forms part of a larger and wider tangible capital asset. Components are normally associated with infrastructure assets. The paved sidewalks surface is one

component of the entire sidewalks and street infrastructure, which also includes the right of way (i.e. land), grade, street signs, etc. A water pump is one component of the water supply system. The component approach to tangible capital assets is the opposite of the single asset approach.

Cost:

Cost is the gross amount of consideration directly attributable to acquire, construct, develop or better a tangible capital asset.

Fair value:

Fair value is the amount of consideration that would be agreed upon in an arms length transaction between knowledgeable, willing parties who are under no compulsion to act.

Financial assets:

Financial assets are assets that could be used to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations. Financial assets include cash, accounts receivable, temporary investments and portfolio investments. Tangible capital assets are non-financial assets.

Intangible assets:

Intangible assets are assets that have no physical form or substance. Goodwill, patents and copyrights are examples of intangible assets. PSAB does not recognize intangible assets. Intangible assets should not be included with tangible capital assets. Software licenses are tangible capital assets.

Infrastructure:

Infrastructure assets are tangible capital assets that are normally comprised of a number of components to form complex network systems. Infrastructure assets are different from general capital assets in terms of access and consumption. The public has unlimited access to infrastructure assets and the benefits of the asset are consumed directly by the public. The government normally restricts public access to general capital assets. General capital assets are used by the government to provide services to the public. Infrastructure assets include sidewalks, streets, bridges, water systems, sewers and surface water control devices such as dams, canals, levies and erosion control devices.

Materiality:

Materiality is the point where a misstatement or aggregate of misstatements in financial statements would influence the decision of a person who is relying on the financial statements. Material misstatements in financial statements can arise from departures from GAAP, errors, fraud, inappropriate accounting estimates and omissions of necessary information.

Net book value:

The net book value of a tangible capital asset is the cost, less the accumulated amortization and the amount of any write-downs.

Operating lease:

An operating lease is a lease in which the lessor does not transfer substantially all the benefits and risks incident to ownership of property.

Network system:

Network system is a term used to refer to infrastructure that has “linear” assets arranged in a continuous or connected network. Network systems normally mean sidewalks, water systems and sewers.

Non-financial assets:

A non-financial asset is an asset acquired, constructed, or developed that does not normally provide resources to discharge existing liabilities, but instead:

- a) are normally employed to deliver government services;
- b) may be consumed in the normal course of operations; and
- c) are not for sale in the normal course of operations.

Residual value:

Residual value is the estimated net realizable value of a tangible capital asset at the end of its useful life. The colloquial term for residual value is “scrap” value.

Segmentation:

Segmentation is the process of breaking down network systems into homogenous groups that are similar in terms of age, material or geography. Segmentation reduces the number of possible identifiable individual assets into a manageable number for valuation. For example, the sidewalks system within a large town could literally be a patchwork of segments of various lengths and age. The streets in the town could be segmented into various pools and amortized using an average age. Newly constructed streets and resurfacing would be recorded on an asset-by-asset basis.

Tangible capital assets:

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

- are used to provide goods and services;
- have an economic life beyond one year;
- are used on a continuous basis; and
- are not for sale in the ordinary course of operations.

Useful life:

Useful life is the estimate of the period over which a tangible capital asset is expected to be used by the government. The life of a tangible capital asset may extend beyond the useful life of the tangible capital asset to a government. Other than land, the life of a tangible capital asset is finite and is normally the shorter of physical, technological, commercial and legal life. Useful life does not necessarily need to be measured in units of time. Useful life can also refer to the number of units of production that can be obtained from a tangible capital asset by the government.

Write-down:

A write-down is a reduction in the cost of an asset to reflect a decline in the asset’s value. A tangible capital asset should be written down whenever the benefits associated with the asset are less than its net book value. A write-down can never be reversed.

Appendix A - Southam Construction Price Index

The SCPI is to be used only for discounting the cost of buildings.

YEAR	INDEX	YEAR	INDEX	YEAR	INDEX
1930	19.0	1966	69.0	2002	364.6
1931	17.7	1967	73.8	2003	370.8
1932	16.3	1968	78.8	2004	387.4
1933	15.8	1969	84.2	2005	396.4
1934	16.1	1970	91.8		
1935	16.1	1971	100.0		
1936	16.7	1972	106.5		
1937	18.0	1973	121.3		
1938	17.6	1974	142.2		
1939	17.6	1975	157.0		
1940	18.7	1976	168.7		
1941	20.6	1977	176.7		
1942	22.1	1978	183.8		
1943	23.3	1979	194.9		
1944	24.2	1980	203.0		
1945	24.3	1981	221.6		
1946	25.2	1982	242.9		
1947	27.8	1983	255.6		
1948	31.2	1984	260.3		
1949	33.1	1985	262.3		
1950	35.4	1986	265.5		
1951	39.6	1987	270.8		
1952	41.8	1988	276.7		
1953	42.8	1989	285.6		
1954	43.4	1990	290.9		
1955	44.6	1991	296.8		
1956	46.3	1992	303.6		
1957	48.3	1993	313.9		
1958	49.6	1994	314.0		
1959	51.8	1995	316.2		
1960	53.5	1996	323.2		
1961	54.9	1997	327.6		
1962	57.0	1998	343.9		
1963	60.6	1999	348.0		
1964	63.4	2000	356.0		
1965	65.8	2001	363.5		

