

# New Reporting Model and Tangible Capital Assets

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**BDO Dunwoody LLP**  
Chartered Accountants  
and Advisors

# Overview

## *Reporting Model Exposure Draft*

- The accrual basis of accounting
- Elements of financial statements
- Financial statement presentation

## *Section PS 3150*

- Key concepts
- Transitional provisions – 3150/PSG 7
- Implementation suggestions



# Accrual basis of accounting

- Accrual accounting the best predictor of cash flows – A/R, A/P, Pensions
- Unrecorded liabilities have cash consequences – future revenue
- Physical assets have cash consequences – available now but have future revenue
- Focusing on short-term can lead to uneconomic decisions

# Accrual basis of accounting

- Historically, F/S focused on short-term cash requirements – tax rates
- Resulted in decisions being made such as providing employees with long-term benefits rather than increases in salaries/wages
- Debt issued on July 1 to avoid interest payments hitting the tax rate



# Accrual basis of accounting

- Not without issues related to existing legislation
- BBL – why & does it have “teeth”?
- Surplus/deficit focused generally on short-term cash – debt principal etc.
- Accrual has no impact on current budgeting
- It will show the effects of funding decisions



# Accrual basis of accounting

- Accrual helps us predict the effects on financial position and results given our funding decisions – is that where we want to be?
- Accrual records revenue from taxation and records the costs of goods and services provided
- If you have not covered your existing costs you will have a deficit
- But, cash management is different



# Accrual basis of accounting

- If you raise revenue to cover costs and repay debt or acquire a new capital asset you will have a surplus
- But repayment of debt results in being better off than before – surplus
- Paying cash for capital asset does not change your position in that year
- However, as that asset ages you can't get the equivalent cash back



# Accrual basis of accounting

- That's why accrual accounting is the best *predictor* of cash flows
- It shows you the effects of decisions today rather than waiting until the cash is actually required
- It does introduce uncertainty to various degrees but is still the best predictor



# Accrual basis of accounting

- Accrual accounting helps us understand the entity's cost of service and how that cost was funded, and in predicting the ability of the entity to meet its obligations and achieve its service delivery responsibilities



# Conceptual framework

- Critical function to provide a set of common premises from which you can begin discussing accounting problems and solutions
- Without it, people with different experiences arrive at different and multiple solutions
- Element definitions are fundamental to the framework

# Elements of financial statements

- Elements are the basic categories of items contained in F/S – not notes
- 2 types – resources/obligations and changes in them revenue/expense
- 4 elements – assets, liabilities, revenues and expenses – note no reference to gains and losses
- Surplus/deficit measured by changes in assets and liabilities

# Elements of financial statements

- This not a “balance sheet” focus
- It is a method of calculating surplus or deficit using the rigour of the definitions of assets and liabilities
- These definitions become critical in the measurement of surplus or deficit
- Assets are first because liabilities refer to sacrificing economic benefits (assets)

# Elements of financial statements

- They help you resolve accounting issues:
  1. what is the asset?
  2. what is the liability?
- If not one of these then it must be a revenue or expense – no “capital” transactions for governments
- Can introduce volatility but that can be the economic reality

# Elements of financial statements

- Consider the definitions of assets and liabilities:  
They each refer to whether you have control over the economic benefit – for assets you have it and for liabilities you have given it up
- Conceptual framework and element definitions help you ask the right questions

# Financial statement presentation

- Requires 4 statements, financial position, operations, net debt and cash flow
- Requires specific indicators to be presented
- Funds and reserves are **NOT** presented but can be included in notes if you choose

# Statement of Financial Position

	2008	2007
Financial Assets	10,912	10,348
Liabilities	18,262	19,171
Net Debt	(7,350)	(8,823)
Non-Financial Assets	7,360	7,457
Net Assets	10	(1,366)



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# Annual Results

	2008 Budget	2008 Actual	2007 Actual
Revenues	14,277	16,322	16,854
<b>Expenses</b>	14,249	14,946	14,303
Annual Surplus	28	1,376	2,551
Opening Net Assets	(1,366)	(1,366)	(3,917)
Closing Net Assets	(1,338)	10	(1,366)



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# Change in Net Debt

	2008 Budget	2008 Actual	2007 Actual
Annual Surplus	28	1,376	2,551
<b>TCA Acquired</b>	(294)	(294)	(250)
<b>Amortization</b>	226	226	230
<b>Net Prepaid Asset</b>		(10)	(20)
<b>Net Inventory</b>		110	(222)
Change in Net Debt	(40)	1,473	2,376
Opening Balance	(8,823)	(8,823)	(11,209)
Closing Balance	(8,863)	(7,350)	(8,823)



# Statement Cash Flows

	2008	2007
<b>Net cash from operations</b>	1,119	3,146
<b>Net cash applied to capital</b>	(248)	(178)
Net cash from investing	129	(178)
Net cash from financing	(789)	(2,481)
Increase in cash equivalents	211	229



# Financial statement presentation

- Requires budget to actual comparison
- Budget on same basis of accounting and for the same reporting entity
- This does not mean that you need to raise taxes or other revenues on an accrual basis
- Nevertheless, you should consider planning funding requirements using accrual information – that's how results are measured



# Goal for the rest of the presentation

- I need you, your client and municipal affairs to get excited about capital asset accounting
- Let me tell you why before we go into Section PS 3150



# Here's the why

- Capital assets – the gift that keeps on taking
  - Some of our highways were named to commemorate Queen Elizabeth – but they were built when she was still a princess \$\$\$
  - Infrastructure deficit = 79,000 hits on Google



# The need for change

- Current reporting = MUBAR
- Trained accountants can't figure it out
- Local government's are in the asset management business
- Engineering and financial systems are specialized, fragmented and incomplete



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# Not just about municipalities

- This is a national issue – the federal and provincial governments all have a vested economic interest
- Everybody governments, taxpayers, councils and investors need to know what is owned and the costs of services provided



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# Better information – for decisions

- Policy makers, financial people don't have good financial information
- It is difficult to judge financial sustainability, flexibility and vulnerability
- It is difficult to assess the affordability of programs and resource allocation decisions



# Section PS 3150

- Section PS 3150

For fiscal years beginning on  
or after January 1, 2009



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## Section PS 3150 – key concepts

- Must be recorded at cost
- Reported as assets on the statement of financial position
- Must be amortized on the statement of operations (cost less residual value)
- Applies to all tangible capital assets



## Section PS 3150 – key concepts

- Definition of cost says capital grants cannot be netted
- Contributed, donated or those from developers at fair value
- Useful life = shortest of physical, technological, commercial or legal life
- Works of art/historic treasures are not recognized



## Section PS 3150

- Allows for capitalization of carrying costs such as interest, when the government has a policy but must be directly attributable to the asset
- Ceases when no construction activity



# Section PS 3150

- Betterments vs. maintenance
- Betterments increase capacity, life etc.
- Maintenance maintains capacity, life etc.
- Depends on how you establish the asset – single asset or component approach



# Section PS 3150

- Useful life needs to be reviewed only when significant events occur:
  - extent or manner of use
  - physical damage
  - demand for service
  - etc.



# Section PS 3150

- How do we get there from here?
  - No inventory of capital assets
  - No cost records
  - No capital asset policies
- Don't despair lots of experience/resources to draw from



# Section PS 3150

- Transitional provisions provide some guidance on valuation
- When you can determine actual cost – use it! (be careful of betterments)
- If not – estimate! Not an exercise in precision
- Deflated depreciated replacement cost
- Allows for different methods for different types of assets



# PSG - 7

- 3150 does not allow for capitalization until all assets have dealt with
- In the transitional period PSG 7 says disclose how much work you have done and not done
- Disclose same information you need to get ready for 3150
- If you don't have the information say which categories remain outstanding



# PSG 7

- This is effective January 1, 2007
- If have not done anything yet, then just say so in the note



# Steps to implement

- Don't do this just to comply with standard and financial statements
- Think about the management information side – it may save you redoing it later
- Figure out capitalization policies for classes of assets – can be different
- This helps identifying what needs to be inventoried

# Steps to implement

- Start small and learn from it
- Decide whether a single asset or component approach best suits that class of asset
- Establish amortization policies – methods, useful life
- Assess valuation methods for suitability



# Steps to implement

- Seek out others for their experiences
- Get on the web and look for various policies used by others
- Go to other standards setters who might have guidance
- Talk to your local associations to see if there is any training/discussion groups

# Steps to implement

- Get excited about the change that is happening – think about the information being provided and what it is trying to accomplish
- In four years it will be business as usual – just in a very different way



# Contact BDO

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