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Background

The Public Sector Accounting Board's (PSAB) presents Canadian municipalities with significant changes on its financial reporting. Starting 2009, all local governments, including Newfoundland and Labrador municipalities, are required to record their tangible capital assets (TCA) in the financial statements and amortize them over their useful life.

This manual is prepared as a useful and practical reference to municipal administrators and Councilors in Newfoundland and Labrador. However, this is not intended to be the final authoritative source for tangible capital assets. Municipalities are encouraged to become familiar with the PS 3150 recommendations and discuss their PSAB compliance and requirements with their auditors.

The Newfoundland and Labrador TCA reference manual is divided into 3 main sections:

Part 1 - PSAB Rules on Tangible Capital Asset (PS3150)

Part 1 provides an overview of the accounting standards or "rules" of PSAB Section 3150 – Tangible Capital Assets.

Part 2 – Identify Your Tangible Assets

Part 2 provides suggestions on how to develop your TCA listings and recommendations on asset classes, useful lives and capitalization thresholds. It also provides some practical advice for identifying TCA.

Part 3 - Determine the Value of Your TCA

Tangible capital assets should be recorded at historical cost. However, many assets were purchased or constructed a long time ago. Section 3 provides recommendations on how to value assets when information on historical cost is not available.

PART 1 – PSAB Rules on Tangible Capital Assets (PS3150)

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.

1.1 PSAB Requirements:

PSAB requires that local governments record their TCA on the statement of financial position (i.e. balance sheet) and amortize them over their useful life. The recording and amortization of TCA represented the last major difference in PSAB GAAP between local and senior governments. Starting January 1, 2009 there will be in effect “One GAAP for all Governments”.

Current Accounting:

Municipalities currently account for their TCA by:

- 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 important in determining the maintenance and replacement requirements of a municipality and should be available to financial statement users.

1.2 What Are TCAs?

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:

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

TCA Includes:

TCA include such diverse items as equipment, computers, computer software, vehicles, buildings, land, roads, bridges, water and sewer systems, dams, and canals.

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 that are worth preserving perpetually would also not be recognized as TCA.

Works of art and historical treasures would include:

- 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 or for the provision of other goods and services.

Heritage buildings that are still being used by the municipality to provide goods and services to the public are TCA. This includes heritage buildings that are being used as museums to display museum collections.

Part 2 - Identify Your Tangible Capital Assets

There are 6 critical questions that you should keep in mind when preparing your TCA listing:

- What TCA do we own?
- Where is it located?
- What is its useful life?
- What is its condition?
- When did we get it?
- What did it cost?

This section deals with the first 5 questions. The 6th question is dealt with in Section 3: "Determining the Value of Your TCA". This section will provide guidance on what you need to consider when preparing your TCA listing at December 31, 2007. This section also suggests sources of information to complete your TCA listing.

Every municipality needs to make a listing of the TCA that it owns as of December 31, 2007. **Your listing of TCA at December 31, 2007 must be completed by September 30, 2008.** The determination of the cost of your TCA or "valuation" does not need to be completed until December 1, 2008.

2.1 Practical Considerations for Identifying Your TCA

Every municipality should obtain a complete listing of their TCA as at December 31, 2007. Beyond visual inspection, there are sources of information that could help in ensuring that your listing is complete.

Land & buildings	-	tax assessment rolls
Buildings & equipment	-	insurance policies
Vehicles	-	MRD/Vehicle Purchase Invoice
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 while at the same time obtaining information about the 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.

Significant, tangible, identifiable capital assets are generally being recorded by municipalities, however, "hard to see" assets are consistently not recorded in the capital funds. "Hard to see" assets include infrastructure such as roads, bridges, and underground assets such as sewer and water systems.

Not all entries recorded in the capital funds qualify as TCA. Items paid for through debentures are always recorded in the capital funds; however, these expenditures are not always for TCA or betterments. They are often for major repairs and maintenance projects. Although an entry is above the threshold limit and is recorded in the capital funds, the nature of the expenditure must be evaluated to determine if it qualifies for capitalization.

Don't Go Too Far Back When Analyzing the Capital Funds:

Keep in mind the useful lives of the various asset classes when searching through the accounting records for TCA. Many TCA could still be in use but fully depreciated at December 31, 2007. **You should record all assets into the accounting records including network systems such as roads, water systems, and sewers. However if they are fully amortized they can be recorded at nominal value.**

The useful life of an asset will tell you how far back you need to go to identify possible TCA at December 31, 2007. Examples include:

Vehicles (useful life of 5 years) – January 1, 2003
Machinery & equipment (10 years) – January 1, 1998
Road construction & maintenance equipment (15 years) – January 1, 1993
Computer hardware & software (4 years) – January 1, 2004

2.2 What is a TCA LISTING?

The first step is the complete initial listing of TCAs. You have to recognize and locate the TCA that your municipality owns. The process is similar to “taking inventory”.

Appendix 1 includes a sample template that municipalities can use to prepare their initial listing of TCA.

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
- Estimated residual value, if any, on disposal

2.3 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 2 lists the various asset classes that a municipality may have and need to record. Each asset is provided with capitalized threshold and estimated useful life.

There may be other municipal assets that are not on the list (Appendix 2). It is up to each municipality to complete the TCA listing.

2.4 Capitalization Thresholds & Materiality

Definition of a 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.

Definition of 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.

Recommended Thresholds For Municipalities in Newfoundland and Labrador:

To achieve consistency across NL municipalities, suggested thresholds are provided for municipalities with less than 1,000 population and municipalities with more than 1,000 populations.

The recommended capitalizations thresholds have been provided in **Appendix 2**.

Capitalization Thresholds Will Reduce the Amount of Work Required:

When preparing the TCA listing consider the likely value of the asset in comparison to the capitalization threshold. If the asset is clearly under the threshold do not include it on your list. At least indicate that it is likely below the threshold. Some municipalities may decide to use the listing for other purposes such as insurance. Removing immaterial TCA from your listing will save you time and effort when you obtain the values.

Year of Acquisition or Reconstruction

It may not always be possible to remember the year of acquisition or whether betterments have been made since acquisition. However the acquisition date and the identification of betterments can be done through a search of the general ledger detail. 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. See the 3rd guiding principle to the valuation of TCA in section 3.1.

2.5 Assessment of Useful Life

Municipalities should use a useful life not greater than the recommended maximum life in **Appendix 2**. The length of the useful life for an asset will depend on the asset quality and its intended use.

Example:

A municipality purchased a used fire truck at a very good price. The used fire truck is 13 years old. The useful life of a new fire truck is 15 years. The pumps and valves on the used truck

were replaced and the suspension was given a major overhaul.

While the useful life of the truck has been extended, the Municipal Administrator CAO feels that the truck will have to be replaced in 10 years. The purchase of a new truck will be financially attractive in comparison to the repairs and maintenance required to keep operating a 23 year old truck.

The Municipal Administrator correctly determines that the refurbished fire truck should be amortized over 10 years.

In some situations, the useful life may be expected to be longer than the recommended life. In such instances, the municipality will need to provide adequate documentation supporting the decision to extend the life beyond the recommended maximum.

2.6 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.

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.

Effects of Single Asset vs. the Component Approach:

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

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

Example:

A municipality can either account for its paved roads as one asset or it can account for the road grade (30 years useful life) and the road surface (20 years useful life) as separate components.

After 20 years, the municipality repaves the road surface. Under the single asset method, the repaving of the street would be maintenance and repairs.

Under the component method, the repaving would be a capital addition. If the old surface was resurfaced after only 15 years it would still have a NBV. The resurfacing would have to be treated as an addition and disposal. The cost and NBV of the old surface would have to be reversed and a loss would have to be recorded.

The amortization expense of the road over its useful life will also be different. Under the single asset method, the total cost of the road will be amortized over 30 years. Under the component method, the cost of the surface will be amortized over 20 years in comparison to the 30 years under the single asset method.

For water systems, the effect on amortization expense could even be more significant. The useful life of water mains could be anywhere from 15 to 60 years depending on their composition, while equipment like pumps and filtration units may have to be replaced every 15 years.

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 NL municipalities use the component approach to the extent reasonably possible.

2.7 Segmentation of Network Systems

Infrastructure assets, such as roads and water & sewer systems, have linear assets that are arranged into a continuous and connected network. A municipality should consider breaking down their network systems into segments. Municipalities will have to decide on how to identify a segment. The level of segmentation will depend on the information required by the municipality. For a rural municipality, the segmentation of road network into paved and unpaved may be all the segmented information it requires. A city would probably require a higher level of segmented information for its street reconstruction program.

For the initial TCA listing, municipalities may use project phases to identify TCA segments. This listing can be further segmented if required by the municipality.

Network systems are normally segmented in terms of location, age and type of material. Examples of segmentation include:

- By towns within a rural municipality
- By date of original construction (original part of town vs. the new subdivision)
- By materials used for water and sewer lines (metal vs. polyethylene)
- Paved streets separate from gravel roads

When recording network systems for the first time, the approach commonly used by governments is to record an initial pool. The pool will gradually shrink due to amortization and replacement. Because the initial pool is one asset, the average age of the network is chosen as the age for the network. On a go-forward basis, a detailed asset listing should be kept as the original pool is replaced and expanded.

The PSAB recommends that a reasonable amount of segmentation be utilized when accounting for infrastructure networks.

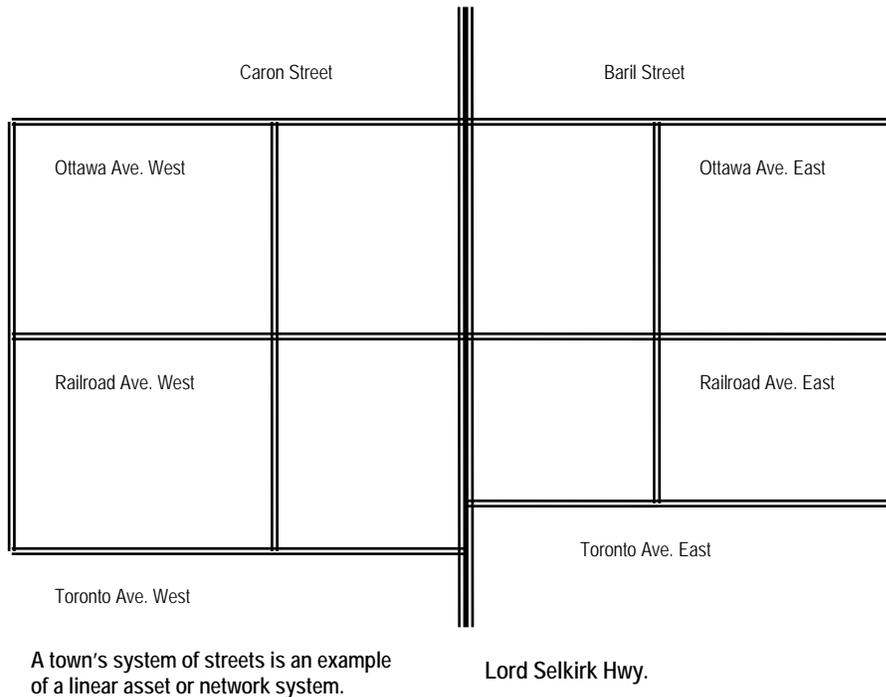
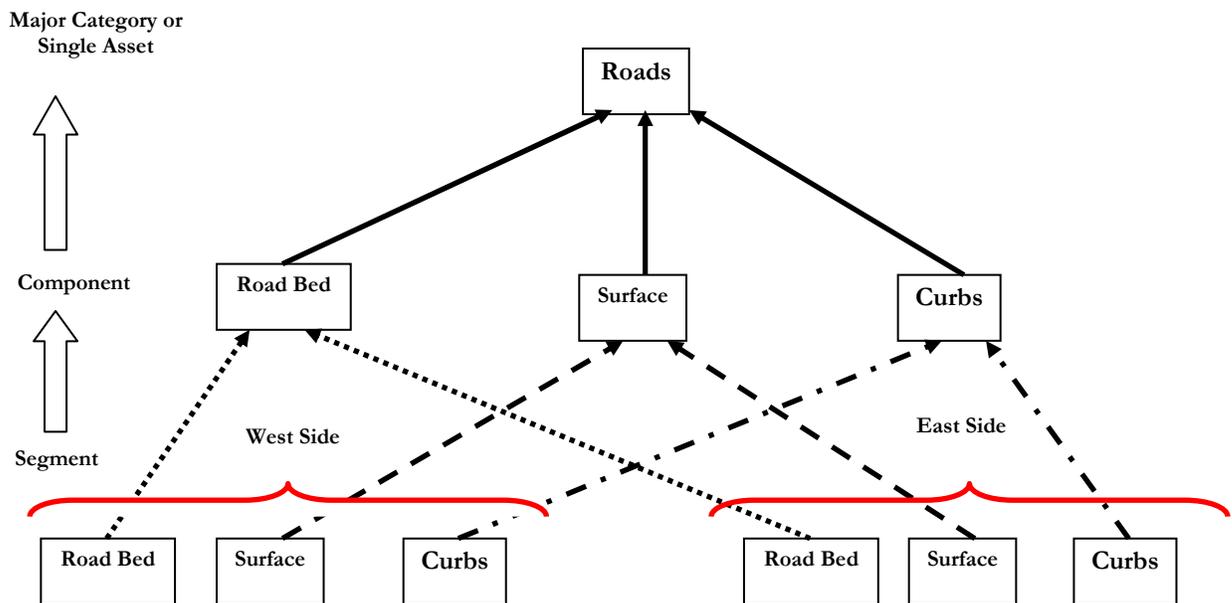


ILLUSTRATION OF SEGMENTATION



2.8 Other Asset Issues

Betterment or Repairs and Maintenance (R&M)?

One of the most difficult decisions in accounting for TCA is determining whether an expenditure is a betterment or R&M. Applying the definition of a betterment is very difficult for complex and long lived assets such as buildings, roads, and water systems.

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:

Most building components/systems have an accepted useful life cycle. The replacement of a component which does not extend the useful life of the building would normally be considered R&M. If the replacement of a component/system occurs towards the end of the useful life cycle of the building and extends the useful life of the building, then the cost may be classified as betterment. For example, a roof replacement in year 20 of a building with a useful life of 40 years would clearly be R&M. However if the roof was replaced near the end of the useful life of the building, and extended the life of the building for another 20 years, then the cost of the roof replacement would be a betterment.

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 road (**betterment** – service capacity)
Put new gravel on a gravel road (**R&M**)
Extended the water main system to a new subdivision (**betterment** – service capacity)
Replaced a broken water main (**R&M**)

Grants from Provincial and Federal Government

Capital grants received from senior governments cannot be netted against the cost of the asset. 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 government capital transfer. The proper accounting treatment for government transfers will be discussed in later training seminars. Infrastructure built through the Federal-Provincial-Canada Infrastructure Program must also be recorded at the gross cost.

Donated TCA / Contributed

Donated or contributed TCA should be recorded at its fair value at the date of contribution. Fair value may be estimated using market or appraisal values. The donation of TCA occurs on a regular basis. Property development companies often build the streets and parks for new subdivisions and then donate the assets to the local government.

Interest Charges

The cost of a TCA can include interest costs directly attributable to the acquisition, construction or development activity. Only interest owed to external parties, such as banks or debenture holders, can be capitalized. Internal finance charges cannot be capitalized as part of the costs of an asset. They must be recorded as an expense of the period.

Capitalization of interest costs end when there is no construction or when the TCA is put into use. A TCA would be considered to be put into use when the asset is being used by the government to provide goods and services to the public, or the public has access to the asset such as a new bridge or road.

Multi-Asset/Bundle Asset Purchases

Often several TCA are acquired together as a single purchase price. The most common example is the purchase of a building and land for a single amount. The total purchase price should be allocated to each asset based on the relative fair value of each asset at the date of acquisition.

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.

Engineering and Project Planning

This would typically include municipal Official Plans or feasibility studies for new facilities or networks. Although this is included in the capital budget and financed from the capital program, these costs are not capitalized.

One exception is when money is spent to conduct an environment 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.

Overhead Costs

PS3150 allows only the costs directly attributable to a tangible capital asset's construction or development activity as overhead. There is also the requirement to be consistent. Costs incurred specifically to facilitate the completion of the project are clearly directly attributable and can be added to the valuation of the resulting tangible capital asset.

2.9 Develop a Work Plan

Municipalities should begin to develop a work plan for TCA shortly after they have completed reviewing the reference manual.

A TCA work plan is a strategic plan that documents how the TCA are going to be identified and valued. The work plan should consider the:

- TCA classes a municipality owns
- Threshold amounts (dollar amounts to be capitalized) for each class
- Locations for each class of TCA
- Individual/department responsible for identifying the TCA (completeness)
- Method for identifying assets in class
- Possible identifiable segments for network systems
- Probability that historical cost information will be available
- Possible alternative valuation methods
- Individual/department responsible for the valuation of the asset

PART 3 – Determining the Value of Assets

3.1 Cost

Historical cost is the most appropriate method to value TCA because it is the most objective. The cost of acquiring an asset is the price paid plus the additional costs to put the asset into service. The cost of a TCA includes the purchase price of the asset and other acquisition costs such as:

- ✓ installation costs
- ✓ design and engineering fees
- ✓ legal fees
- ✓ survey costs
- ✓ site preparation costs
- ✓ freight charges
- ✓ transportation insurance costs
- ✓ duties

Historical cost evaluation requires municipalities to examine their past financial records to the extent they exist, in an attempt to match the financial records with their TCA listing.

If historical costs are not available, municipalities may use the discounted replacement cost method of valuation. The discounted replacement cost is the cost of replacing an asset with one that is substantially similar and discounting the value to the date of original acquisition.

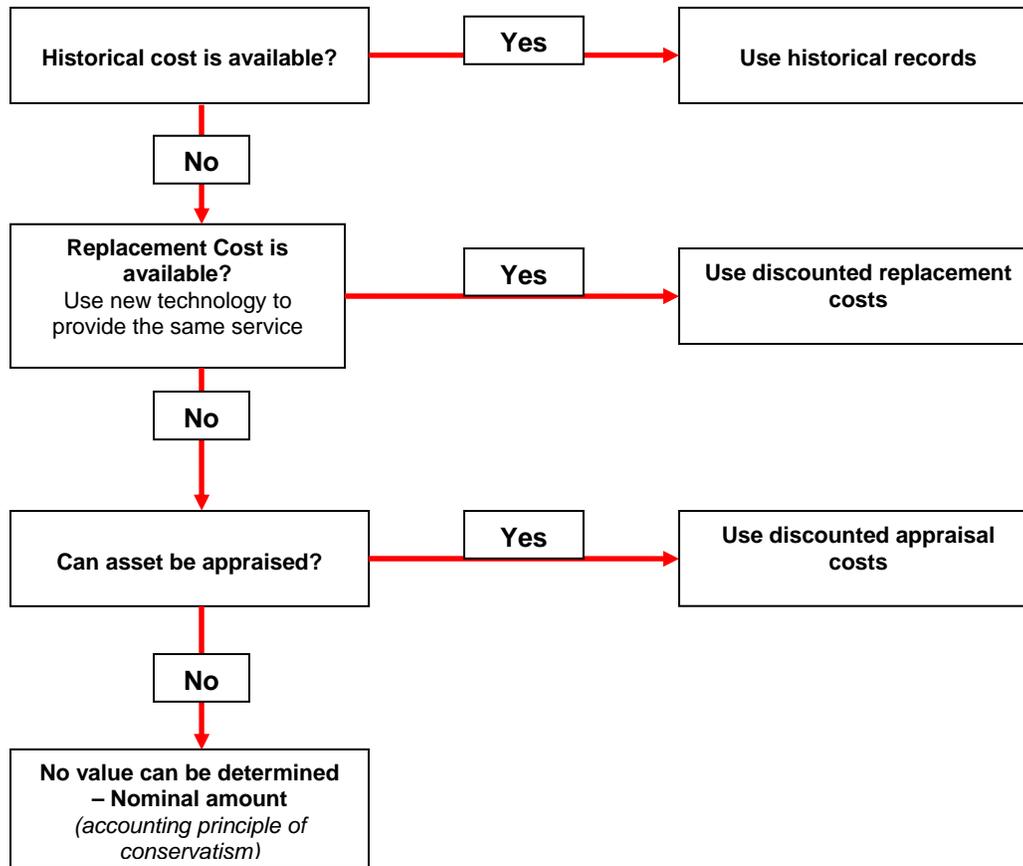
Also, municipalities may use discounted appraisal cost to determine the value of a TCA. The appraised value should be discounted to the date of original acquisition. Municipalities may already have TCA appraised values for insurance purposes.

The nominal value should only be used if the historical cost, the discounted replacement cost, or the discounted appraised value cannot be determined, or if the TCA is fully amortized.

For NL municipalities, it is recommended to use the following overall valuation approach:

- Always use historical cost whenever the information is readily available;
- Use discounted replacement cost if information on the historical cost is not available;
- Use nominal values if there is no information at all.

The following decision tree has been created to guide municipalities in the process of completing the initial valuation of their capital assets.



3.2 Discount Rates

There are various discount rates that can be used to discount reproduction, replacement and appraisal value back to original costs of the assets. However, for consistency purposes, it is recommended that NL municipalities use the Consumer Price Index. It is readily available and easily understood.

<http://www.bankofcanada.ca/en/rates/inflationalc.html>

Regression table for CPI is found on Appendix 3.

3.3 Amortization

All TCA, **except land**, have limited useful lives. TCA are used to provide services to the public. The cost of these assets has to be allocated in a rational method over the useful life of the asset. Where a municipality expects a residual (i.e. scrap) value to be significant, it should be factored into the calculation of amortization.

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

Amortization costs should be accounted for as an expense in the statement of operations.

The difference between the initial cost of a TCA and its accumulated amortization to date is its unamortized balance or net book value (NBV).

Straight Line Method:

It is recommended that NL municipalities use the straight line method as it is the most common and easiest method of amortization. This method assumes that the use of the asset is constant over its useful life. Straight line amortization is calculated by dividing an asset's original cost, less its residual value if any, by its estimated useful life in years.

Example:

A municipality purchases a brand new truck for \$40,000. The truck is estimated to have a useful life of 10 years. After 10 years, the truck is estimated to have a residual value of \$2,000. The annual amortization charge is:

$$(\$40,000 - \$2,000)/10 \text{ yrs} = \$3,800 \text{ annual amortization charge.}$$

The entry into the general ledger would be:

Dr. Amortization expense	\$3,800	
Cr. Accumulated Amortization – Vehicles		\$3,800

3.4 Write-downs

Regular Review of Remaining Useful Life:

The amortization method and 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. 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
- change in the extent that an asset is to be used
- change in the useful life of an asset is a change in an estimate and not a change in an accounting policy. The financial statements of previous years do not have to be restated for a change in an estimate.

When conditions indicate that a TCA no longer contributes to a municipality's ability to provide goods and services, or the future value of the TCA is less than its NBV, the cost of the TCA should be written down to its appropriate value.

The write-down of a TCA should be accounted for as an expense in the statement of operations.

A write-down should never be reversed.

Example:

A municipality developed overnight camp sites in its local park along the river. The cost of the development was \$60,000 and the camp sites were put into use on May 1, 1998. The useful life of the camp sites was determined to be 30 years with no residual value. In the spring of 2007, severe flooding occurred and damaged the campsites beyond further use. The municipality could not obtain flood insurance.

The NBV of the camp sites at May 1, 2007 would be \$42,000 ($60,000 - (60,000/30 \times 9 \text{ yrs})$).

The entry to record the write-down would be:

Dr. Accm Amortization – Land improvements	18,000	
Dr. Loss on write down	42,000	
Cr. Land Improvements		60,000

3.5 Disposals

On the disposal of a TCA, the difference between the net proceeds and the NBV should be accounted for as a revenue or expense in the statement of operations.

Example 1:

A municipality purchased a vehicle on June 30, 2004 for \$31,000. The municipality determined that the vehicle had a useful life of 10 years with a residual value of \$1,000.

On June 30, 2007 the municipality decided to sell the vehicle to another municipality for \$20,000.

The NBV of the vehicle at June 30, 2007 was \$22,000 ($\$31,000 - ((\$31,000 - \$1,000)/10 \times 3 \text{ yrs})$).

The loss on the sale of the vehicle would be \$2,000. The entry to record the disposal would be:

Dr. Cash (proceeds on sale of vehicle)		20,000
Dr. Accumulated Amortization – Vehicle	9,000	
Dr. Loss on sale of vehicle		2,000
Cr. Vehicle		31,000

Example 2:

A municipality built its municipal office building for \$120,000. The building was put into use on January 1, 1980. The building has a useful life of 40 years with no residual value. The building was insured at replacement value.

On December 31, 2007 the municipal office building burnt down. Replacement cost for a similar building at December 31, 2007 was \$200,000.

The NBV of the building at December 31, 2007 was \$36,000 ($\$120,000 - (\$120,000/40 \times 28 \text{ yrs})$). The gain after the insurance proceeds was \$164,000. The entry to record the gain would be:

Dr. Cash (insurance proceeds)	200,000	
Dr. Accumulated Amortization – Building	84,000	
Cr. Building		120,000
Cr. Gain on insurance proceeds		164,000

3.6 Nominal Values for Fully Amortized Network Assets

Infrastructure for many municipalities was originally built in the 1970's or earlier. In many cases there has been very little in the way of major capital reconstruction or expansion projects since then. The infrastructure for these municipalities are still being used but are fully amortized at December 31, 2007. These assets have no NBV remaining to be amortized. Their inclusion or omission from a municipality's list of infrastructure assets would have no effect on the balance sheet at December 31, 2007 or future income statements.

Network assets such as **roads, streets, water systems and sewers** represent significant capital investments and are used to provide essential services for the public. Therefore, they should be included as part of a municipality's list of assets at December 31, 2007 even though their inclusion has no effect on the surplus or future operating results. Their inclusion as part of a municipality's listing of assets may be required in the future for capital planning and investment purposes.

Municipalities should assign nominal values for fully amortized network assets that are still being used by the public and maintained by the municipality, and historical cost or replacement cost information is not available.

The nominal values should be used for fully amortized network assets such as roads and streets and waters sewer systems.

The nominal values should only be used if a municipality does not have historical cost information available or cost information on comparable assets to calculate an appropriate replacement or appraisal cost.

3.7 TCA Continuity Schedule

A TCA Continuity Schedule is being designed and will be provided for your use. The required information will then be rolled up into a Summary Schedule. The information on the Summary Schedule can be used to prepare the required note disclosure for the financial statements.

The only information that has to be imputed into the schedule is the description of the asset, the cost, the date put into use, and the date of disposal if applicable. The worksheet will calculate:

The accumulated amortization to December 31, 2007
The NBV at December 31, 2007
The amortization for 2008 and 2009
The accumulated amortization at December 31, 2008 and 2009
The NBV at December 31, 2008 and 2009

The Continuity Schedule will calculate the accumulated amortization for each TCA to December 31, 2007. The Continuity Schedule will also provide the NBV of each asset and asset class at December 31, 2007. The TCA Continuity Schedule will also track your TCA additions and disposals for the years ended December 31, 2008 and 2009.

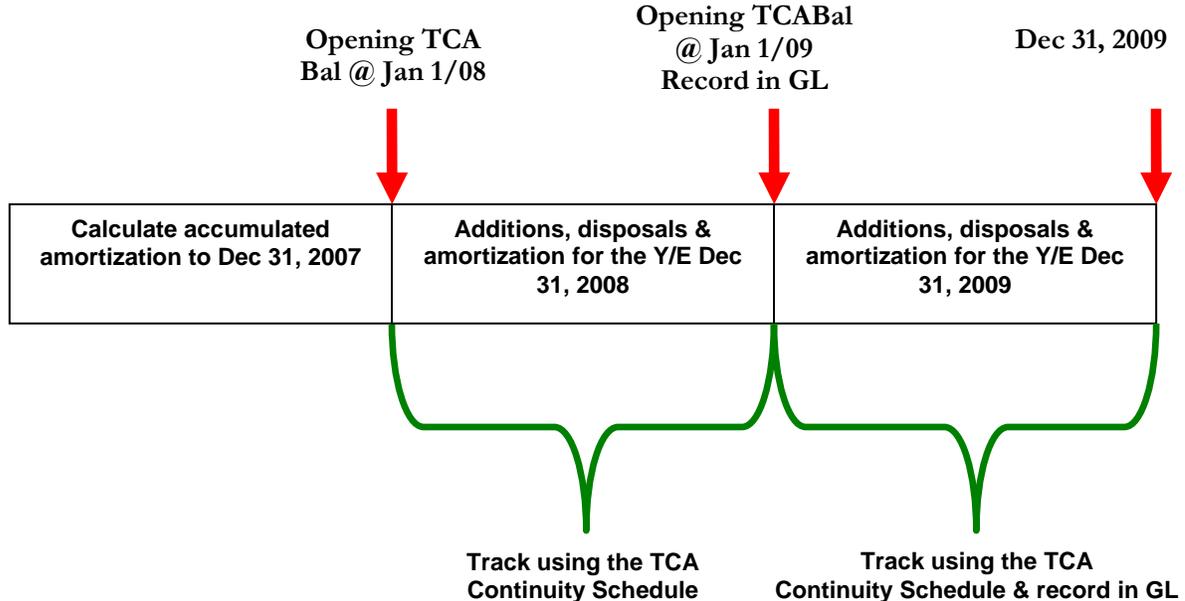
There is a separate worksheet for each class. The worksheet is designed for assets amortized on a straight line basis. The amortization formulas will have to be overwritten if a different amortization method is used.

3.8 Amortization and Entry for Opening Balances

After you have listed and valued all your TCA, you must:

- For each TCA, calculate the accumulated amortization to December 31, 2007
- Track TCA additions and disposals for the year ended December 31, 2008
- For each TCA, calculate the amortization expense for the year ended December 31, 2008
- Enter the opening TCA balances into your accounting records as of January 1, 2009
- For each TCA, calculate the amortization expense for the year ended December 31, 2009 into your GL accounts.

Timeline for Tracking and Recording TCA:



Calculate the Accumulated Amortization to Dec 31/07:

For each TCA you must calculate the accumulated amortization to December 31, 2007.

Example:

A municipality's office building was put into use on January 1, 1980. The municipality calculated the discounted replacement 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 a straight line basis.

The annual amortization charge would be \$6,250 ($\$250,000/40$ years) and the accumulated amortization at December 31, 2007 would be \$168,750 ($\$6,250 \times 27$ yrs).

Track Additions & Disposals for the Y/E Dec 31/08:

You will need to track your TCA additions and disposals during 2008 just as if PSAB was already implemented. **Do not record your 2008 TCA additions and disposals into your GL.** You should continue to use the current accounting practices during 2008.

The TCA Continuity Schedule can be used to track your 2008 additions and disposals. For additions, simply input the description of the asset and the date acquired or put into use during the year. The Continuity Schedule will include the asset as an addition of 2008.

For disposals, simply input the disposal date and the Continuity Schedule will show the asset as being a disposal of 2008. The Continuity Schedule will also reverse the accumulated amortization to date for the asset.

The TCA Continuity Schedule will provide a total of the additions and disposals for each class.

Calculate the Amortization Expense for the Y/E Dec 31/08:

For each TCA, 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 TCA Continuity Schedule can be used to calculate the 2008 amortization expense for all your TCA at December 31, 2007 and all your additions and disposals during 2008. The Continuity Schedule will total the 2008 amortization expense for each class.

The TCA Continuity Schedule will provide the cost, accumulated amortization and NBV at December 31, 2008 for each individual asset and asset class.

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 2008 was \$6,250 ($\$250,000/40$).

The accumulated amortization for the building at December 31, 2008 would be \$175,000 ($\$168,750$ at Dec 31/07 + \$6,250 for 2008).

The NBV of the building at December 31, 2008 would be \$75,000 ($\$250,000 - \$175,000$).

Enter TCA Balances at Jan 1/09 into GL:

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

- Reverse or in effect eliminate your current "Fixed Asset" balances in your GL
- Create a "cost" account for each TCA asset class that your municipality owns
- Except for land, create an "accumulated amortization" account for each "cost" account or asset class
- Create an "amortization expense" account for each capital fund (general and utility) that your municipality uses

GL accounts for **water and sewer infrastructure** should be included in the **capital funds**. Some rural municipalities have a utility capital fund for every community in the municipality. Your water and sewer infrastructure should be segmented and posted to the appropriate utility funds.

All other TCA classes should be included in the general capital fund.

Example (cont'd):

The municipality's GL showed a "Fixed Asset" balance of \$157,000 at January 1, 2009.

The municipality first reversed the "Fixed Asset" balances in the GL:

Dr. Capital Fund – Surplus	\$157,000
Cr. Capital Fund – Fixed Assets – Bldgs	\$157,000

The municipality then created a cost account "Buildings" and an accumulated amortization account "Accm Amort – Buildings". They then created an amortization account called "Amortization Expense". These 3 accounts were all created in the General Capital Fund (GCF).

The entry to record the opening TCA at January 1, 2009 would be:

Dr. GCF – Buildings	\$250,000
Cr. GCF – Accm Amort – Buildings	\$175,000
Cr. GCF – Surplus (i.e. the NBV)	\$ 75,000

In the above example, the municipality owned only 1 building. You would not enter your opening TCA balances at January 1, 2009 on an asset by asset basis. In situations where you have more than 1 TCA in the class, you would simply enter the class total.

Record Your Amortization Expense for the Y/E Dec 31/09 into your GL:

For each TCA, you will need to calculate the amortization expense for the year ended December 31, 2009 into your GL.

Example (cont'd):

The amortization expense for the year ended December 31, 2009 would be \$6,250 (\$250,000/40).

The entry for recording the 2009 amortization expense would be:

Dr. GCF – Amortization Expense	\$6,250
Cr. GCF – Accm Amort – Buildings	\$6,250

The accumulated amortization at December 31, 2009 would be \$181,250 (\$175,000 + \$6,250) and the NBV would be \$68,750 (\$250,000 - \$181,250).

The TCA Continuity Schedule can calculate the amortization expense for each TCA and TCA class. The Continuity Schedule will also track your TCA additions and disposals during 2009. Finally the TCA Continuity Schedule will provide the cost, accumulated amortization and NBV for each TCA and TCA class.

3.9 Presentation & Disclosure

Financial statement presentation and disclosure requirements for TCA are briefly discussed here for information purposes only.

Disclosure of TCA Balances:

The financial statements should disclose, for each major category of TCA and in total:

- Costs at the beginning and end of the period;
- Additions in the period;
- Disposals in the period;
- The amount of any write-downs in the period;
- The amount of amortization of costs of TCA for the period;
- Accumulated amortization at the beginning and end of the period; and
- Net carrying amount at the beginning and end of the period.

The information above is normally disclosed in a TCA note to the financial statements or as a supporting schedule. Below is an illustration of a supporting schedule that can be modified to include the required information.

For example:

	2009			2008		
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE
LAND	\$ xx	\$ -	\$ xxx	\$ xx	\$ -	\$ 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

Significant Accounting Policies Note:

Financial statements should also disclose the following information about TCA:

- The amortization method used, including the amortization period or rate for each major category of TCA;
- The net book value of TCA not being amortized because they are under construction or development or have been temporarily removed from service;
- The nature and amount of contributed TCA received in the period and recognized in the financial statements;
- The nature and use of TCA recognized at nominal value;
- The nature of works of art and historical treasures held by the government; and
- The amount of interest capitalized in the period.

This information is normally disclosed as part of the significant accounting policies note to the financial statements.

Example:

Tangible capital assets

Tangible capital assets are recorded at cost. Amortization is recorded over the estimated useful lives of the assets on a straight-line basis at the following rates:

<i>Buildings</i>	<i>x%</i>
<i>Furniture and fixtures</i>	<i>x%</i>
<i>Machinery and equipment</i>	<i>x%</i>
<i>Computer equipment</i>	<i>x%</i>

3.10 The Guiding Principles to the Valuation of TCA

1st Principle:

The historical valuation of TCA is a balance between making reasonable estimates and assumptions on the original costs to meet audit requirements. Everyone, including the auditors, must understand that the initial valuation process is not an exercise in precision.

2nd Principle:

It is much more important to be accurate on a go-forward basis than it is to obtain exact costs for older assets.

3rd Principle:

It is not necessary to obtain cost information on TCA that have been in use beyond their estimated useful life. These assets will be fully amortized at December 31, 2007. Consider computers with a useful life of 4 years. It would not be necessary to obtain cost information on computers in use prior to January 1, 2004. Any computer in use prior to that date would have a NBV of nil at December 31, 2007.

4th Principle:

The cost precision required for long lived assets (buildings, infrastructure) decreases proportionately with the length of time the asset has been in use. Municipalities should be able to obtain detailed and precise cost information for buildings and infrastructure constructed in the recent past. However if an asset has been in use for a lengthy period then the availability of information may be reduced. This is not as critical as the effect of older assets on the statement of operations will be of a short duration. Reasonable assumptions and estimates are sufficient for older long lived assets.

If a specific date cannot be ascertained for a TCA, then 6 months of amortization should be recorded in the year of acquisition. In other words, the date of acquisition is July 1st.

Keep All Documentation of Costs:

It is imperative that municipalities keep copies of all their supporting documentation and calculations for the costing of their TCA at December 31, 2007. The auditors will need this information to verify the opening TCA balances for fiscal 2008.

3.11 Role of the Auditor

Because every auditor must maintain professional independence there are certain limitations on how the auditor can be involved.

- Your auditor **can** assist in developing your work plans to implement the requirements.
- Your auditor **cannot** be directly involved in the valuation process or in data gathering.

Discuss the requirements and impact of PS3150 with your auditor as soon as possible. Determine the best approach to obtain the required information. Ongoing communication with your auditor will help avoid problems down the road. The amount of the audit fee will be affected by the quality and amount of work completed by the municipality.

3.12 Other Sources of Information

For those municipal administrators who would like to obtain additional information on how to implement PS3150 there are some very good websites. These additional sources provide valuable recommendations on preparing an implementation plan, determining resource needs, and asset management issues:

The PSAB Guide to Accounting for and Reporting Tangible Capital Assets
http://www.psab-ccsp.ca/index.cfm?ci_id=18656&la_id=1

The Ontario Municipal Benchmarking Initiative (OMBI) – The OMBI Municipal Guide to Accounting for Capital Assets, Version 2 (February 15, 2007)
<http://www.caobenchmarking.ca/accounting.asp>

The Municipal Finance Officers' Association (MFOA) and the Association of Municipal Managers, Clerks and Treasurers of Ontario (AMCTO)
<http://www.amcto.com/db/assetmgmt.asp>

3.13 Contact Information

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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 road surface is one component of the entire road 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 roads, 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 roads, 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 road 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 1 - TCA Listing Sheet

**Appendix 2 - Asset Classes, Capitalization Thresholds &
Amortization Rates**

Appendix 3 - Consumer Price Index Tables