City of Richmond

Report to Committee

To:	Finance Committee	**Date:**	March 18, 2010
From:	Jerry Chong Director, Finance	**File:**	
Re:	**Tangible Capital Asset Project**		

Staff Recommendation

That the report from the Manager of Budgets & Accounting on the Tangible Capital Asset Project be received for information.

Jerry Chong
Director, Finance
(604-276-4064)

FOR ORIGINATING DEPARTMENT USE ONLY		
CONCURRENCE OF GENERAL MANAGER		
REVIEWED BY TAG	YES ☑	NO ☐
REVIEWED BY CAO ACTING	YES ☑	NO ☐

2871011

Staff Report

Origin

The purpose of this report is to provide information regarding the changes to the City's audited financial statements as a result of the changes in financial reporting standards as set out by the Canadian Institute of Chartered Accountants (CICA). The Public Sector Accounting Board (PSAB) of the CICA, sets standards for financial accounting and reporting in the government sector. It has introduced new standards for capital asset accounting and reporting for local governments effective January 1, 2009 to standardize the practice with every other reporting body including the private sector, public sector and senior level governments. These reporting entities have been tracking and reporting capital assets in their financial statements in this manner for many years. Canadian local governments are the last ones to comply with these standards.

At the November 16, 2009 Finance Committee meeting, a Tangible Capital Asset Project Update report was presented on the status of the project.

This is a follow up report to present

1. Information collected as a result of this project
2. Impact on the City's financial statements
3. Impact on budgeting for amortization expense
4. Impact on the City practices in relation to capital expenditures
5. Resource plan to maintain the information as required by PSAB for 2010 and beyond.

Analysis

1. Information collected as a result of the project

Under Generally Accepted Accounting Principles (GAAP), all reporting bodies are required to prepare their financial statements based on historical cost. Therefore the cost information collected on capital assets are the original or historical costs at which the assets are acquired or constructed. These costs do not represent the current or future replacement cost of the assets. Current and/or future replacement costs are addressed by each individual department as they have current information regarding prevailing market rates and City requirements and this is provided for information in the following table under the column heading "Estimated Replacement Cost". This is an especially important issue for the future and ongoing replacement of the City's infrastructure and building assets.

The capital asset inventory as at December 31, 2008 (subject to audit) has been completed with the following information:

- Acquisition date
- Estimated useful life
- Original cost/Historical cost
- Amortization expense

This information has been collected from various departments who are the custodians of the assets. This inventory will be updated to December 31, 2009 as part of the 2009 year end audit.

The following schedule shows a high level view of the capital assets owned by the City as at December 31, 2008.

Asset Inventory as at December 31, 2008 (in 000s)
(Unaudited)

Asset Category	Historical Cost	Accumulated Amortization	Net Book Value (NBV)	% of NBV to Historical Cost	Amortization Expense 2008	Estimated Replacement Cost
Land	$ 467,379	-	$ 467,379	100%	-	$ 12,900,000
Buildings						
Oval **	167,329	-	167,329	100%	-	167,000
Other Buildings	109,141	60,511	48,631	45%	4,950	214,000
Infrastructure						
Storm Drainage	425,148	131,879	293,269	69%	5,731	1,160,000
Water Works	187,644	75,323	112,321	60%	2,852	570,000
Roads	424,037	208,787	215,250	51%	10,576	325,000
Bridges	49,379	9,276	40,103	81%	638	n/a
Street Lights	31,140	10,926	20,214	65%	534	n/a
Dikes	18,099	12,136	5,963	33%	362	250,000
Sanitary Sewer	210,805	76,515	134,290	64%	3,179	483,000
Parkland Improvement	58,314	21,694	36,620	63%	2,700	85,000
Equipment						
Information Technology	15,476	11,337	4,139	27%	1,137	n/a
Traffic Signals	25,003	9,685	15,318	61%	918	31,300
Fleet	20,053	14,383	5,670	28%	1,489	34,200
Fire and Other Community Safety Equipment	10,577	5,989	4,589	43%	704	16,500
General	434	-	434	100%	-	400
Library	8,515	6,077	2,438	29%	827	13,400
Work In Progress	20,000	-	20,000			
Grand Total	**$ 2,248,474**	**$ 654,517**	**$ 1,593,957**	**71%**	**$ 36,597**	

** Oval costs represent only the building cost. The landscaping costs of $10.3M are included in Parkland Improvement.

Historical Cost – Original cost incurred to acquire or construct an asset. We have used estimates to arrive at the costs where records are not available as some of the acquisitions date back to the 1900s.

Accumulated Amortization – The reduction in value over the estimated useful life of an asset as a result of its use and wear and tear.

Net Book Value – Remaining cost of an asset after reducing it by its accumulated amortization. It also represents the remaining cost to be amortized during the remainder of its useful life. Overall net book value of the assets is 71% of the historical costs.

Annual Amortization Expense (2008) – This represents the portion of the tangible capital asset(s) which is deemed to have been consumed or expired over the year, and has thus become an expense. The historical cost is divided by the total estimated useful life and the resulting amount is the annual expense. It also represents the annual cost of operations that decreases the net book value of an asset.

Source of information

Land
Source – Amanda System, Land Title Office, City Archives and estimates by Real Estate Services.

Building
Source – VFA system, Facilities department and Major Projects department for the Oval.

Infrastructure
Source – Engineering Planning, Design and Construction section, Major Projects department, GIS system, PMS system and Parks department.

Equipment
Source – Fleet management system, IT Altirus system, Fire Rescue department.

Library
Source – Library

2. **Impact on the City's financial statements**

The restated financial statements for 2008 are shown below. These re-statements are un-audited, hence subject to adjustments.

The highlighted areas represent changes to the statements. These changes are explained as follows:

Consolidated Statement of Financial Position (see below)

Overall, the value of tangible capital assets has increased by $219M reflecting a corresponding increase in the capital equity. This can be attributed to:

- Inventory of capital assets takes into account all additions including developer contributed assets, land under roads, all disposals including abandonment of underground infrastructure assets and any amounts previously un-recorded.
- The value of capital assets is now based on the original cost of acquisition less the accumulated amortization or the reduction in value due to use and wear and tear. The resulting value is called the net book value.

The new standards also require the City to show the value of inventory of supplies and prepaid expenses as Non-Financial assets. Corresponding changes are reflected in the City's financial equity, specifically surplus. These changes are to standardize with accounting practices followed by all other reporting bodies.

Consolidated Statement of Financial Position (in 000s)				
		2008 (Audited)		2008 Restated (Unaudited)
Financial Assets				
Cash and Investments	$	557,518	$	557,518
Receivables		33,045		33,045
Development fees receivable		9,732		9,732
Debt reserve fund		449		449
		600,744		600,744
Liabilities				
Accounts payable and accrued liabilites		75,935		75,935
Deposits and holdbacks		41,701		41,701
Deferred revenue		34,627		34,627
Development cost charges		48,857		48,857
Lease obligation		927		927
Long-term debt		18,317		18,317
		220,364		220,364
Net financial assets		380,380		380,380
Non-financial assets				
Tangible capital assets		1,375,243		2,248,474
Accumulated amortization				(654,517)
Net book value				1,593,957
Inventories of supplies		2,412		2,412
Prepaid expenses				444
	$	1,758,035	$	1,977,193
Equity				
Reserves		273,339		273,339
Appropriated surplus		93,028		93,028
Surplus		33,438		36,294
Obligations to be funded from future revenue		(181)		(181)
Capital Equity		1,355,999		1,574,713
Other equity		2,412		
	$	1,758,035	$	1,977,193

	Financial	Capital	Other	Total
Equity as previously reported	$ 399,624	$ 1,355,999	$ 2,412	$ 1,758,035
Adjustments:				
Prepaid Expenses	444			444
Inventory of supplies	2,412		(2,412)	-
Tangible capital assets restated		218,714		218,714
Equity end of year	$ 402,480	$ 1,574,713	$ -	$ 1,977,193

Consolidated Statement of Financial Activities

- Capital expenditures of $126.1M in the original statements are no longer treated as a current year expenditure. These are now capitalized as part of the costs of capital assets.
- Amortization expenses of $36.6M are treated as a current year expenditure.
- The resulting difference of $89.5M is an increase to the financial equity.
- Prepaid expenses of $0.44M are reduced from the operating expenditures and reflected in the City's financial equity.

Consolidated Statement of Financial Activities (in 000s)

	2008 (Audited)	2008 Restated (Unaudited)
Revenues		
Development cost charges	$ 9,506	$ 9,506
Other capital funding sources	35,960	35,960
Operating revenues	307,398	307,398
	352,864	352,864
Expenditures		
Capital and infrastructure investments	126,094	
Amortization expense		36,597
Operating expenditure	230,356	229,912
	356,450	266,509
Excess (deficiency) of revenue over expenditures	(3,586)	86,355
New capital lease obligations	726	726
Repayment of debt and capital lease obligation	(3,231)	(3,231)
Increase (decrease) equity	(6,091)	83,850
Equity , beginning of year	405,715	405,715
Equity, end of year	$ 399,624	$ 489,565

What does the re-statement of the financial statements mean to the City?

Net worth:

As explained above, the increase of $219M in the net book value of the assets translates into an increase in the net worth of the City for the current period. This will be of particular interest to the users of our financial statements and now provides them with the ability to compare our financial position with other reporting bodies.

Replacement reserve:

The accumulated amortization of $654M represents the estimated reduction in value of the City's capital assets as a result of usage and wear and tear since their acquisition. These assets would have to be replaced at some future point in time based on their useful life, condition assessment and maintenance practice. Therefore, based upon generally accepted accounting principles (GAAP) our replacement reserve target should approximate the accumulated amortization of $654M plus inflation.

3. Impact on budgeting for amortization expense

Currently, the City does not budget for amortization expense which is a non-cash expense. However, GAAP requires the City to record it as an expense in the financial statements thereby creating a difference between the budget and the financial statements. The practice of budgeting for amortization expense will be reviewed for 2011. Recognizing amortization as an expense or a cost of operations has an implication on the City's costing models. For example, calculation of user fees or charge out fees could include a cost component of the usage of the assets in delivering those services.

4. Impact on the City practices in relation to capital expenditures

- The City must track all additions and deletions/disposals of its capital assets. For example, if 100 meters of water main were replaced, we would have to show the addition and what has been deleted or discarded. Another example would be, how many vehicles have been purchased and how many are disposed.
- Not all costs associated with the acquisition or the construction of an asset will be considered capital expenditures. For example, under GAAP the cost of a feasibility study is not considered to be a capital expenditure. Overhead expenses other than those that are directly attributable to the acquisition or the construction are not considered capital expenditures.
- The City will have to review its capital and operating budget processes to incorporate some of these requirements.
- The new standards do not have an impact on the usage of the capital funding sources. For example, DCC funding can still fund DCC qualified capital projects regardless whether they can be capitalized under the new accounting standards.

5. Impact with resources in order to maintain the information as required by PSAB for 2010 and beyond

The information required by PSAB on capital assets is complex and needs to be maintained on an ongoing basis. Although the Finance Division will coordinate the process of information collection, there needs to be active involvement of other departments. In particular, Infrastructure assets being the largest component of the City's asset base and also the most complex, requires additional staff resources to coordinate between project managers, inspectors, GIS group and the Finance division to gather and analyze information. Based upon the review of PSAB increased requirements and after discussions and consultation with other Municipalities, we have identified the need for additional resources that will be raised as part of the 2011 budget process.

Financial Impact

None at this time.

Conclusion

The primary goals and objectives of the TCA project such as completing the asset inventory and incorporating changes to the City's financial statements have been accomplished pending the completion of the 2009 audit. However, continued process changes and improvements will be required to ensure the flow of accurate capital asset information between departments and to ensure conformance with GAAP. The information generated as a result of this project will be valuable to decision makers in planning asset replacement strategies at the corporate level and developing an understanding of the infrastructure deficit and the health of the replacement reserves.

Hari Suvarna

Hari Suvarna, CGA
Manager, Budgets & Accounting
(604-276-4365)
HS:hs