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Winnipeg

Capital Assets Review

Final Report
April 2007

Audit Department

Leaders in building public trust in civic government

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Mandate of the City Auditor

The City Auditor is a statutory officer appointed by City Council under the *City of Winnipeg Charter Act*. The City Auditor reports to Council through the Audit Committee (Executive Policy Committee) and is independent of the City Administration. The City Auditor conducts examinations of the operations of the City and its affiliated bodies to assist Council in its governance role of ensuring Civic Administration's accountability for the quality of stewardship over public funds and for the achievement of value for money in City operations. Once an audit report has been communicated to Council, it becomes a public document.

Background

The Public Sector Accounting Board (PSAB) serves the public interest by setting standards and providing guidance for financial and other performance information reported by the public sector. PSAB was established to improve and harmonize public sector accounting and to enable better comparability of financial performance and results between governments in Canada. PSAB has recently issued several new accounting standards that pertain to local governments. Among the new standards is a section of the *Public Sector Accounting Handbook* (the Handook) that deals with capital assets (Section PS 3150 – Tangible Capital Assets). This section of the Handbook is to take effect for the fiscal year beginning on or after January 1, 2009. This section will require the City to account for all capital assets and their use in the financial statements.

PSAB's move to full accrual accounting for local governments will provide the foundation of financial information for a better understanding of the costs of using capital assets in service delivery. The financial statements will provide more information on assets and will broaden the current one-dimensional focus on the annual surplus or deficit by requiring a more comprehensive set of indicators that will be more useful to the public and to City administration in the sustainable management of these assets. The new method of accounting for tangible capital assets will provide better information about the sustainability of assets and services to City Council and senior administrators for their considerations during the operating and capital budget processes.

The City's tangible capital assets represent a very significant asset, with a book value of $5.9 billion and a net book value of $3.7 billion. The City, along with the other Canadian municipalities, did not maintain inventory information for all of its tangible capital assets because there was no specific requirement. Most City departments did not maintain capital asset data. For certain asset classes (such as roadways), departments interested in pursuing a more rigorous asset management program endeavored to maintain an inventory and rate the condition of the capital assets under its care.

Historically, the City only reported the capital assets on the financial statements that were financed. These assets were valued at the corresponding value of the outstanding debt (which was net of any grants received). These assets were amortized each year by an amount equal to the reduction in the principal amount each year. This clearly did not accurately reflect the actual cost of the asset or its true costs of use (i.e. amortization) nor did it account for the assets that were purchased without financing.

In 2006, the Controllership Division of Corporate Finance initiated the tangible capital asset project with the objective of ensuring the City would be in compliance with these accounting standards for tangible capital assets for the fiscal year ended 2006, well ahead of the 2009 deadline. To accomplish this task, the Controllership Division with the assistance of the

departments had to identify and list all assets, determine the cost of the assets and determine estimated useful life and amortization method for all of the City's tangible capital assets. This was a considerable challenge given that the City had not maintained an inventory of all of its capital assets. Due to the significant impact on the financial statements of implementing these new accounting guidelines and the potential impact on the delivery of services the Corporate Controller requested the Audit Department to perform a review of the project in addition to the audit work being performed by the City's external auditors.

Audit Objectives

The objectives of the Capital Assets Review were to determine whether

- the appropriate process is in place to ensure the accuracy and completeness of the information on capital assets being recorded, amortized and reported on the financial statements is compliant with Section PS 3150 – Tangible Capital Assets of the *Public Sector Accounting Handbook*; and

- the appropriate capital asset information is being developed and maintained to provide the City with an adequate foundation to build an effective sustainable asset management program, consistent with best practices.

Audit Scope and Methodology

The capital asset project was coordinated by the Controllership Division of the Corporate Finance Department. At the Corporate Controller's request, we reviewed the processes, practices and policies in place for the identification, measurement, amortization and reporting of the City of Winnipeg's capital assets for the purposes of preparing the financial statements.

In addition, we wanted to ensure that the collection and development of the capital asset information would form the foundation for the start of corporate-wide comprehensive sustainable asset management planning. As our reference, we relied on the *Managing Infrastructure Assets – Infraguide: National Guide to Sustainable Municipal Infrastructure 2004*. Our review was limited to assessing whether the information collected on the City's capital assets was sufficient to answer the first two questions of the *Seven Key Questions* for an effective sustainable asset management plan (see table below).

Seven Key Questions
(for an effective sustainable asset management plan.)

1. What do have and where is it? (Inventory)
2. What is it worth? (Costs/ replacement value)
3. What is its condition and expected remaining service life? (Condition and capability analysis)
4. What is the level of service expectation, and what needs to be done? (Capital and operating plans)
5. When do you need to do it? (Capital and operating plans)
6. How much will it cost and what is the acceptable level of risk(s)? (Short- and long-term financial plan)
7. How do you ensure long-term affordability? (Short- and long-term financial plan)

Source: *Managing Infrastructure Assets – Infraguide: National Guide to Sustainable Municipal Infrastructure 2004*

We also reviewed the audit work of the City's external auditor's, Ernst & Young, with respect to the City's compliance with Section PS 3150 of the Handbook.

The conclusions in our report are based upon information available at the time. In the event that significant information is brought to our attention after completion of the audit, we reserve the right to amend the conclusions reached.

Audit Conclusions

The review work we performed led us to the following conclusions:

1. The Controllership Division has the appropriate processes in place to ensure the accuracy and completeness of the information reported on capital assets in the financial statements. The information reported on capital assets is in compliance Section with PS 3150 – Tangible Capital Assets of *the Public Sector Accounting Handbook.* We did note in our review that land valuations were conservative in nature, in part due to lack of historical data, and in some instances, amortization periods were also conservative.

2. Overall, the information on capital assets collected and developed through this project has established the basic foundation within the City to begin to build a corporate-wide effective sustainable asset management plan.

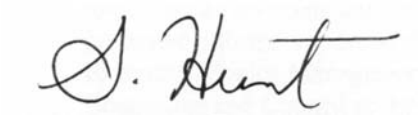
Acknowledgement

The Audit Department wants to extend its appreciation to the management and staff from the Controllership Division who participated in the review, and to the staff of Ernst and Young for their cooperation.

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April 2007
Date

Observations

Our review consisted of two components. The first component was to ensure that the City's reporting of tangible capital assets is in compliance with Section PS 3150 of the *Public Sector Accounting Handbook*. The second component was to determine whether the capital asset information that is being collected and maintained is sufficient to enable the City to develop an effective sustainable asset management program.

PSAB Compliance

With respect to the first component of our review we needed to assure ourselves that the key assertions with respect to accounting for tangible capital assets were addressed. They are as follows:

- *Completeness* – that there are no unrecorded assets
- *Existence* – that an asset of the City exists at a given date
- *Ownership* – that an asset is owned by the City at a given date
- *Valuation* – that an asset is recorded at an appropriate value

We designed procedures to satisfy ourselves that these key assertions were adequately addressed by the processes developed by the Controllership Division to report on the City's tangible capital assets. The key review procedures we performed included the following:

- We interviewed key staff in the Controllership Division.
- We reviewed their file summary notes to determine if the methodology used in recording and reporting on tangible capital assets was adequate.
- We interviewed Ernst and Young staff to determine the extent of their work and to review their observations with respect to the capital asset files.
- We reviewed the draft accounting guideline for *Capital Asset Accounting* issued by the Controllership Division to determine if key risks were adequately addressed in the guideline document.
- We reviewed the tangible capital asset files compiled by the Controllership Division to determine if the files were consistent with the methodology outlined in the file summary documents and information we collected through interviews.
- We reviewed the tangible capital asset files to ensure there was adequate support for the tangible capital assets in terms of completeness, existence, ownership and valuation as reported on the summary lead sheets by department.
- We compared the accounting policies of the Special Operating Agencies to the City's policies and ensured that the process to consolidate the Special Operating Agencies' tangible capital assets adequately accounted for any differences.
- We relied on Ernst & Young's work in ensuring the tangible capital asset figures reported in the financial statements agreed to the general ledger.
- During our review we did identify a few issues that required further explanation or work by the Controllership Division to resolve in order to satisfy the objectives for this review. These issues are outlined in *Appendix 1: Observations*. All issues were satisfactorily addressed by the Controllership Division during the review period.

As a result of our review we are satisfied that the methodology used by the Controllership Division to ensure the completeness, existence, ownership and valuation of the tangible capital assets recorded, amortized and reported on the financial statements of the City is adequate and is in compliance with Section PS 3150 – Tangible Capital Assets of the Handbook. We noted that the Controllership Division paid particular attention to the high value assets such as Water and Waste infrastructure, roads and bridges, which

represent approximately 83% of the book value of tangible capital assets. For these asset groups a comprehensive process was employed to accurately identify and value all assets in these classes. We also noted that the Controllership Division's methodology in arriving at both the valuation and the amortization period ensured that these estimates were conservative in nature so that the City's tangible capital assets were not overstated.

Asset Management – Building the Foundation

Overall, the information on capital assets collected and developed through this project has established the capacity within the City to begin to answer the first two questions related to effective asset management: "What do you have" and "What is it worth?". We did find some areas where the information collected would not be able to satisfy the first two questions. Two areas that will require further refinement are as follows:

- In some cases, primarily in the areas of building equipment and other equipment, the data is collected on a program versus itemized basis making it difficult to determine what specific assets the City owns and where they are located.
- Salvage values are assumed to be zero for all but a few types of vehicles, which in some cases can distort the life cycle cost of the asset.

Recommendation 1

We recommend that the Corporate Controller revise the *Capital Asset Accounting* guideline to require departments that are responsible for the management of capital assets to maintain an itemized inventory of building equipment and other equipment and to establish salvage values for all capital assets. This information is required to perform life cycle costing.

Management Response

On a prospective basis, an itemized inventory listing will be maintained for all building equipment and other equipment in accordance with the capitalization threshold guidelines established by Corporate Finance.

The information on capital assets compiled by the Controllership Division comes from several sources and does not reside in one specific system. We believe that the City should work towards a full integration of the systems used in the departments to collect and maintain capital asset data with the PeopleSoft system used by Corporate Finance for financial reporting.

Recommendation 2

We recommend that the Corporate Controller should work towards a full integration of the systems used in the departments to collect and maintain capital asset data with the PeopleSoft system used by Corporate Finance for financial reporting.

Management Response

Corporate Finance will be implementing the PeopleSoft Asset Management module over the next five years. As this implementation proceeds, Corporate Finance will evaluate any opportunities to integrate the system with existing life cycle costing systems in other departments.

Next Steps

The capital asset project was not intended to develop all the information on capital assets required to develop an effective corporate-wide sustainable asset management plan. This section of the report is intended to encourage the development of the necessary data and information on capital assets that is required to manage them on a sustainable basis.

We believe the information on the tangible capital assets owned by the City compiled by the Controllership Division provides the City with a good foundation from which to build better asset management systems. This is consistent with the following view expressed by the Vice-Chair of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants: "These

new standards will provide the foundation of financial information needed to understand the costs of using capital assets in service delivery. It will promote ongoing asset condition assessments and improved financial planning related to maintenance and replacement needs." The City must build on this foundation of capital asset information to realize the most significant benefit of maintaining capital asset information, which is to ensure the City can effectively manage its capital assets on a sustainable basis.

Managing Infrastructure Assets – Infraguide: National Guide to Sustainable Municipal Infrastructure 2004 identifies the information on the capital assets that must be collected and maintained in addition to the inventory and cost of the asset. This information includes the following:

- the condition of the asset,
- the estimated service life,
- the desired service level,
- the estimated future maintenance and refurbishment costs,
- the estimated future replacement costs, and
- the current sources of funding.

The collection and maintenance of this information is necessary to support life cycle costing. Life cycle costing analysis is an integral part of preparing a sustainable strategic asset management plan for the City.

We believe the departments that are responsible for the management of the assets are in the best position to collect, maintain and analyze the information on the assets that is needed to support life cycle costing analysis. Once the City has the required information on all of its capital assets to answer the *Seven Key Questions,* it will be in a position to develop a strategic asset management plan. The development of a strategic asset management plan will provide better information for use in the capital and operating budget processes and should assist the City and the public in the determination of a sustainable level of service that can be offered by the City.

Recommendation 3
We recommend that the Corporate Controller in cooperation with the departments develop a plan for the collection and maintenance of the information on capital assets that is required for the City to develop a corporate-wide strategic asset management plan.

Management Response
Corporate Finance will be developing a corporate-wide strategic asset management plan in partnership with other civic departments over the next five years. Corporate Finance will work with departments to ensure that the information necessary to support this plan is collected and maintained in the City's information systems.

Appendix 1: Observations Reported to the Corporate Controller

Item #	Audit Observation	Action required	Corporate Finance Response	Audit Conclusion
1	No salvage values for assets are used except for Police vehicles and Fleet vehicles. The practice of assuming a zero salvage value is not consistently applied across the same asset class.	Need documentation to support decision to record salvage value as zero in most asset classes (i.e. evaluation of impact on yearly depreciation, estimated value of salvage value or policy decision clearly outlined in accounting guideline).	Corporate Finance reviewed on a class-by-class basis and compared estimated salvage value to original cost of asset. If this was immaterial, Corporate Finance decided to use no salvage value for ease of implementation.	Satisfactory. The methodology used to determine the salvage value of the capital assets was adequately supported and appears reasonable.
2	Historical cost valuation – Noted two different methods for determining historical cost values were used. 1. Historical cost where cost information was available, 2. Discounted estimated replacement cost if actual costs were not available (which is permitted under PS 3150). We noted that in some instances where historical cost information was available for some assets within an asset class the discounted replacement cost formula was not tested to determine if it resulted in similar valuations except for Water and Waste's capital assets.	Where some historical cost information is available, test the reasonableness of the discounted replacement cost formula and quantify the potential differences, if any. Document any reasonableness tests performed on the values produced by the discounted replacement cost formula.	In general, Corporate Finance did a high level review for reasonableness of valuations. Corporate Finance will review files and will document this where data is available.	Satisfactory. The valuation methodologies used appear reasonable. The historical costs are based on the best information available (i.e. replacement cost estimates and discount rates used).
3	Land valuation – values used for land appear overly conservative. Per working paper file Property Planning & Development indicated that land held by City is worth between $1 and $75 per square foot, but used the assessed values that averaged to less than a $1 per square foot for valuation purposes. Was the reasonableness of the assessed value tested?	Determine, if possible, the extent to which the land may be undervalued and/or test the reasonableness of using the assessed value as a substitute for current replacement value.	Corporate Finance used best possible data available. Corporate Finance noted that the zoning of parcels of land significantly affects the value of the land and significant portion of land is zoned park land, which has a low market value.	Satisfactory. The land valuations appear reasonable based on the available information.

Appendix 1 (cont'd)

Item #	Audit Observation	Action required	Corporate Finance Response	Audit Conclusion
4	Amortization period – Noted that some of the amortization periods chosen by Corporate Finance need additional support. (i.e. Fire Paramedic vehicles)	Obtain documentation to support amortization periods chosen or provide written explanation approved by the department controllers and the Corporate Controller.	Corporate Finance will provide support for amortization periods where necessary.	Satisfactory. Amortization periods selected are adequately supported and appear reasonable.
5	Is there adequate provision for impairment in value in land regarding environmental and other concerns?	Review procedures for preparing provision for impairment in value relating to environmental and other concerns.	Corporate Finance annually requests feedback from each Department on potential environmental costs associated with City property and the estimate provided in the financial statements represents the City's best estimate.	Satisfactory. The process for determining the provision for the impairment in value to the capital assets appears reasonable based on the information provided by the departments.
8	Support for testing for existence and completeness regarding roadways and bridges was not found on file. In our interviews, it was mentioned that tests were randomly performed to ensure streets were accounted for in database. We did not find evidence to support this in our review of the working paper files.	Procedures to verify existence and completeness of roadway and bridge inventory should be documented.	Corporate Finance will document procedures regarding existence where possible.	Satisfactory. Procedures for ensuring existence and completeness are adequately documented and appear reasonable.
9	Capitalizing some of the expenses on a program versus item basis will limit the usefulness of the information for departments for asset management purposes. Note: primarily a concern with buildings and building improvements and equipment. Roads and Bridges and Water and Waste recorded on an item basis.	A Plan for future integration of the capital asset information in format that is useful and relevant to both Corporate Finance and departments should be developed.	Integration of data for asset management is planned to be part of subsequent phases of the tangible capital asset project.	Satisfactory. Corporate Finance is committed to developing a plan to ensure the development of a sustainable asset management information system.