

PSAB/Asset Management

NEWSLETTER NO. 2

From PSAB Compliance to Integrated Financial Planning

As we indicated in our initial announcement newsletter, MFOA and AMCTO, working closely with OMAA and other associations, will be producing newsletters on a regular basis covering three main topics: PSAB accounting changes, asset management plans and integrated financial plans. This newsletter sets out our vision of the relationships among these three activities and why moving beyond mere PSAB compliance makes good financial and managerial sense.

One of the most significant trends in municipal finance in recent years has been the increasing emphasis on the stewardship of capital assets. Many jurisdictions struggle with the costs related to maintaining and/or replacing their existing assets and others have financial pressures to put in place the assets needed to accommodate growth. A great deal of discussion has taken place with regard to “infrastructure deficits.” While there is no universally agreed-on definition of infrastructure deficit, one definition is the added investment in assets that would be required to maintain them at appropriate service levels and in a good state of repair.

PSAB changes with regard to the accounting treatment for tangible capital assets, plus a number of provincial and federal initiatives that require asset management plans, together present an ideal opportunity for municipalities to move to a comprehensive system of asset management, including integrated financial plans that provide for the financing of those assets.

Our Vision

Put simply, we are of the view that:

- Building inventories for PSAB compliance without using those inventories for forward looking asset management is a waste of an opportunity.
- Asset management plans that do not have financing components or that have not been used to determine user fees, debt management strategies, reserve contributions, etc. are incomplete.
- Therefore, we are recommending moving beyond PSAB compliance, using the inventory you build for PSAB purposes, to develop asset management plans and ultimately financing plans that integrate your asset needs into your user charges, and capital financing strategies.



PSAB Compliance

PSAB accounting changes found in PS 3150 (tangible capital assets) and PS 1200 (financial statements) will require municipalities to reflect their assets in their financial statements. While we are aware of the discomfort that some of our members feel with these changes, there is no denying that tangible capital assets are currently not taken into account in existing municipal financial statements. This has probably contributed to the “infrastructure deficit” since assets can be more easily ignored when they do not appear in our financials or budgets. For example, tax rates can be kept low by deferring maintenance since the depreciation of our assets is not currently taken into account. Unless a municipality has been proactive and developed an asset management plan—as many have in recent years—there is no way to know if the amounts we spend maintaining our assets is adequate across the sector.

The disconnect in the public sector between accounting statements and tangible capital assets is being addressed by accounting standard setters in most developed countries. Canada is not leading the trend, but is following a trend already underway in other countries as well as at senior levels of government within Canada.

In the near future, our Newsletters will provide assistance with regard to PSAB compliance by covering such topics as:

- Formulating a PSAB action plan
- Talking to Council about PSAB changes such as accounting for tangible capital assets
- Implications of moving to full accrual accounting from modified accrual accounting
- Technical issues with regard to PSAB such as structuring your inventory, asset valuation, asset depreciations, accounting for betterments, etc.

Further into 2007, the Newsletters will deal with the new financial statements and provide guidance on what they mean and raise issues about the implications of these changes for municipal budget making.

Asset Management

With respect to asset management, the signals are everywhere that asset management in the public sector is now a serious subject. These signals include:

- Changes with respect to tangible capital assets made by PS 3150
- Asset management plans required by the federal government of gas tax recipients
- Asset management plans required by the provincial government of gas tax recipients
- Asset management plans, and funding reports that will be required under the regulations to the [*Sustainable Water and Wastewater Systems Act, 2002*](#)

- Creation of the [Ontario Ministry of Infrastructure Renewal](#) and the adoption of multi-year infrastructure investment plans
- Creation of [Infrastructure Canada](#)
- Creation of [Infraguide](#) by the [Federation of Canadian Municipalities](#) and other national organizations
- Numerous reports and studies identifying the nature and magnitude of the infrastructure deficit and the funding that will be required to address it. As one example, see the [Report of the Water Strategy Expert Panel](#) which estimated that municipalities need to spend \$34 billion by 2019 to maintain and replace water and wastewater infrastructure. Based on historical spending patterns, they will spend approximately \$16 billion, leaving a funding gap of \$18 billion or \$1.2 billion per year at the time it was written (page 8).

It is difficult to escape the conclusion that there is a new focus on asset management. There is also no doubt that municipalities own significant amounts of public assets worth tens of billions of dollars (the [Report of the Water Strategy Expert Panel](#) estimates that the stock of water and wastewater assets only is about \$72 billion, most of which is municipal). The need for asset management plans is inescapable!

TCA Accounting ≠ Asset Management

PSAB compliance is not the same as asset management. PS 3150 will require municipalities to have an asset inventory and to value their assets based on historical costs. However, it will not require the preparation of a forward looking asset management plan based on life cycle costing approaches. It is possible to comply with PS 3150 and end up with no asset plan at the end of that exercise. This would be a lost opportunity. The asset inventory that is needed for PSAB could, and should, be the foundation for forward-looking asset management plans for all major asset classes. The asset inventory is the link between tangible capital asset accounting and a full asset management plan. One of the most important early messages with regard to working toward PSAB compliance is to structure your asset inventory in such a way that it is able to serve as the foundation for PSAB as well as a comprehensive asset management strategy.



For PSAB purposes, it is possible to construct an inventory with relatively few categories (e.g. land, buildings, and equipment). While this might be adequate for PSAB, it would fall far short of what is required for a strategic and comprehensive asset management plan. We would encourage you to give serious thought to the information needs you have around assets (e.g. historical costs, condition ratings, depreciated costs, replacement costs and year of replacement to identify a few) and the level of detail that is required (e.g. lumping water pipes together with treatment plants might be adequate for PSAB but not for an asset management plan).

With regard to asset management, upcoming Newsletters will not focus on the wide range of technical issues related to asset management but will instead focus on describing the benefits of a comprehensive approach to asset management and will point readers to selected quality source material on asset management.

Integrated Financial Plans

Without a comprehensive asset management plan, it is difficult to know if a municipality's financing strategies are adequate. The [Report of the Water Strategy Expert Panel](#) argues that Ontario has some of the lowest water rates in the world largely because rates "do not cover the full costs of service" (p. 13). One of the key missing costs in the rates are costs associated with the rehabilitation and replacement of existing assets. If the full costs of managing and maintaining assets are not known, it is difficult to know:

- If various user fees (e.g. water rates) are adequate or too low
- The true costs of the service levels Council establishes
- Whether current reserve contributions for capital are adequate to cover future infrastructure projects
- Whether our capital plans are shrinking our infrastructure deficit or allowing it to grow.

We hope to encourage the adoption of capital plans that deal with operating as well as capital and integrate all future costs associated with assets and their long-term maintenance. This type of approach will ensure that user rates are adequate, that future major works are largely anticipated, and that financing strategies can be properly employed to smooth out the lumpiness in long-term capital plans.

No Need To Do Everything All At Once

Many of our members believe that complying with PSAB will be a significant challenge. To move beyond PSAB to asset management and comprehensive integrated financial plans could be too onerous for some by the PSAB deadline of 2009. The good news is that you do not have to do everything all at once for 2009. We are recommending that municipalities set as a goal the preparation of an integrated financial plan, but work on such a plan might well continue after the deadline for PSAB compliance has past. If the inventory designed for PSAB compliance is in sufficient detail to later support an asset management plan, that plan can come later, as can the integrated financial plan that will be required to fund it. For municipalities with more limited resources moving to integrated financial plans may take several years. However, we think the work will be well worthwhile and our Newsletters will highlight the benefits of such plans and what they might look like.

For more information and resources regarding tangible asset management, go to [PSAB/Asset Management](#), or contact:

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