

The Corporation of the Township of Gillies Administration Report

Report # 2010/06

Date: June 14, 2010

ISSUE: Tangible Capital Assets, Budgeting for Amortization and Capital Investment Plan

BACKGROUND:

Beginning with the fiscal year 2009, municipalities are required to report on their tangible capital assets (TCAs) and to move from a modified accrual format to full accrual accounting with new financial statements, as provided by PSAB 3150 (Public Sector Accounting Board Standard).

Under the modified accrual accounting format, tangible capital assets were recorded as an expense in the year purchased, and then forgotten about, unless money was borrowed to finance the expenditure. After the initial purchase of the asset, the asset no longer appeared in the financial statements, even though the asset is still in service and money is invested in the asset.

Under the full accrual accounting method, the cost of the asset is no longer a one-time expense, but rather the amortization (depreciation) of each asset is what becomes recorded as an expense each year. For example, the purchase of a \$100,000 grader will be recorded as an addition to the tangible capital assets of the municipality, and if the grader's life expectancy is 10 years, using straight-line depreciation, a \$10,000 expense will show on the books for the next 10 years, until such time the grader is disposed of.

Full accrual accounting gives a better financial picture of the financial health of a municipality since it shows the investment in infrastructure and the cost or depreciation of the infrastructure.

DISCUSSION:

PSAB 3150 compliance was an accounting exercise; a prescriptive process that created a consolidated tangible capital asset inventory and historical costs, looked at defined capital costs (amortization) and reported on the financial statements.

Given the work done around asset inventories, government and municipal associations and agencies are encouraging municipalities to move beyond compliance and use those inventories as the basis for comprehensive asset

management plans. An asset management plan should be viewed as a strategic management tool which will also help inform various financial decisions that could include:

- Assessment of overall spending priorities;
- Set infrastructure spending priorities;
- Determine level of tax and user fees rates;
- Assess accountability for resources;
- Make judgements about asset performance;
- Assess financial capabilities;
- Make cost comparisons;
- Reserve fund adequacy analyses; and
- Debt management strategies.

The ultimate goal is to encourage long-term financial planning where asset management is a key component.

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.

TCA Accounting is not Asset Management

PSAB compliance (tangible asset accounting) is not the same as asset management. PSAB 3150 requires municipalities to have an asset inventory and to value their assets based on historical costs. However, it does not require the preparation of a forward looking asset management plan based on life cycle costing approaches (the cost of an asset divided by its lifespan; the result being amortization or the cost to eventually replace the asset). It is possible to comply with PSAB 3150 and end up with no asset plan at the end of that exercise. Some may consider this a lost opportunity. The asset inventory that is needed for PSAB is 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.

Results

For the 2009 reporting year, the Township of Gillies is compliant with the new financial statement reporting standard for tangible capital assets. PSAB compliance was a great undertaking with much administrative time spent on

asset inventories, evaluation and reporting for audit and financial statement purposes.

Schedule 'A' attached shows the assets owned and maintained by the Township of Gillies as of December 31, 2009. The schedule shows the Gross Book Value (historical cost of asset), year in service (purchased); expected useful life of asset, amortization (depreciation; cost of using asset) and the resulting net book value (current value of asset).

Each tangible capital asset is grouped into one of two asset classes: (1) General Capital; and (2) Infrastructure.

General Capital Assets are tangible capital assets that are not part of the infrastructure Asset Class, including but not limited to Parks, Fire and Landfill.

Infrastructure Assets are tangible capital assets that are composed of linear assets and their associated specific components, generally constructed or arranged in a continuous network, including but not limited to Transportation Infrastructure (Roads – including bridges, culverts).

Assets are then further broken down into sub-classes:

- Land;
- Land Improvements;
- Buildings;
- Roads;
- Bridges & Culverts;
- Equipment & Machinery;
- Licensed Vehicles;
- Technology & Communication.

The information in Schedule 'A' was used to be compliant with PSAB 3150 for reporting tangible capital assets and amortization in the 2009 financial statements. However, much more information can be gleaned from the Schedule to help make financial decisions respecting tangible capital assets as discussed previously. A good starting point is that all assets owned and managed by the municipality are listed, along with their expected useful remaining life. This allows decision makers to know what the municipality has and how long it will last. The life of tangible capital assets can be extended through **betterments**, which are subsequent expenditures on tangible capital assets that increase previously assessed physical output or service capacity; lower associated operating costs; or improve the quality of the output. Any other expenditure would be considered a repair or maintenance and expensed in the year it is incurred. Knowing the life expectancy of an asset allows for pre-planning to replace or better the asset prior to it failing. Amortization is important since it helps decision makers realize the cost of using an asset. Amortization should be viewed as the money that needs to be put aside to eventually replace the asset.

For Gillies, this dollar value that should be put into reserves each year to eventually replace assets as they near the end of their expected useful life is approximately \$241,881.

It should be noted that although the historical cost of assets does not provide full information on the cost to replace these assets, it is intended to reflect the past transactions that are verifiable and reliable. It does however raise the awareness of the existence of these assets and their cost. The depreciation of these assets as an expense reflects the cost to utilize these assets in the provision of services.

Many municipalities are faced with an infrastructure deficit. That is, there has not previously been enough money set aside each year to replace assets. Smaller municipalities tend to be reactive to capital spending, and consider replacing an asset once it has failed, or to expend money on repairs to “get by”. The reason for this has been that municipalities have not had the information on the cost of using assets. Even now, with PSAB 3150, knowing this information does not help municipalities who do not have the financial resources or assessment base to begin saving for asset replacement. The situation is no different for the Township of Gillies.

Budgeting for Amortization

Ontario Regulation 284/09, under the *Municipal Act, 2001*, as amended, provides that a municipality may exclude from expenses, for the purpose of budgeting, all or a portion of amortization expense; post-employment benefits; and landfill closure/post-closure expenses. Beginning in 2010, the municipality shall, before adopting the budget, prepare a report with recommendations with respect to the excluded expenses, which is to be adopted by resolution of Council. This report is to include: an analysis of how the report’s recommendations will impact on the accumulated surplus to the end of the year; and an analysis of the impacts of the report’s recommendations on future funding requirements for tangible capital assets if the excluded expenses are not funded. For 2010, this report must be prepared and adopted by council resolution within 60 days of receiving and adopting the 2009 audited financial statements. For subsequent years, the report must be prepared and adopted by council resolution prior to adopting the budget.

As indicated, yearly amortization costs are approximately \$242,000 a year, and landfill closure/post closure expenses are estimated at \$11,000 (estimate until final landfill report received from TBT Engineers). There are currently no post-employment benefits offered by the Township. Budgeting for these two expenditures would mean \$253,000 added to the budget each year. Given the tax base of the municipality, budgeting for these amounts is unrealistic.

However, this being said, there is debate about who should pay for the replacement of tangible capital assets. Should it be the residents who are

currently using the asset, or those future residents who received no benefit from the asset? For an example, the roads and the landfill; at present the current residents drive the roads and deposit their waste in the landfill. Over time these assets depreciate and require replacement. The current residents are paying for the daily operation and maintenance of these assets, but there is no money being set aside for their eventual replacement. Years from now, once a road is depleted and the landfill full, the residents at that time will be faced with the cost of replacing the roads and the council of the day faced with how to fund the expenditure. Case in point is the current fire pumper and the upcoming tandem replacement that the current council and the next term council will be facing. The Township of Gillies has been fortunate in being able to rely upon additional government funding to help replace assets, but it seems that this funding pool may be coming to end. An excerpt from the Association of Municipal Managers Clerks and Treasurer of Ontario's (AMCTO) June 3, 2010 Legislative Express states: *"Managing their way through a situation where, at least until 2014-15, the government will spend \$10 to \$20 billion more each year than it plans to take in, sends probably the strongest signal to the municipal sector that any further re-balancing of provincial municipal finances, like what was experienced in 2008 (with the gradual uploading of Ontario Works costs and court security costs) will not arrive any time soon. On the federal front, the Prime Minister signaled to the recent FCM [Federation of Canadian Municipalities] conference that the type of stimulus spending the government has involved itself in with municipalities will not be repeated."*

Linking PSAB Compliance to Asset Management to a Capital Investment Plan

Section 8.1 of the Federal Gas Tax Agreement states, *"the Recipient acknowledges and agrees to undertake and complete, prior to the end of the fourth year of this Agreement, a Capital Investment Plan."* The Federal Gas Tax Agreement defines a Capital Investment Plan as *"a document, such as a capital plan, created through a public process, with approval from municipal elected officials, providing a detailed understanding of anticipated investments into tangible capital assets that are considered 'priorities', along with a rationale."* So, simply put, now that the municipality knows what it owns, how old it is and how much it is worth, it can figure out how much it will cost to replace, how much to save by when and how to pay for it all and put this into a document and call it a Capital Investment Plan. This plan was to be adopted by March 31, 2010, or if a municipality indicates that it is working toward a plan with a defined completion date, this satisfies compliance with the Agreement. Federal Gas Tax Funds may be used toward creating a Capital Investment Plan under the Capacity Building component. The Township of Gillies could not complete the plan by the March 31st deadline, since the information on the tangible capital assets was not completed and approved by the auditor at that time. It was reported that the Township is working toward compliance by the end of 2010. Most of the plan is

easy to complete given the work done for PSAB compliance. The difficult piece in completing the plan is “how to pay for it all”.

OPTIONS: Council has the option of whether or not to move PSAB compliance forward to Asset Management, with the realization that the continuing receipt of Federal Gas Tax dollars depends on the adoption of a Capital Investment Plan. Council also has the option of whether or not to budget for amortization and landfill closure/post closure costs.

RECOMMENDATIONS: This report is for information purposes only to help Council understand the presentation of the upcoming 2009 Financial Statements, obligations under the Federal Gas Tax Agreement and to provide knowledge of municipal asset costs and replacement costs.

SUBMITTED BY: Karen Caren, Clerk-Treasurer