
DATE: October 10, 2007

SUBJECT: **CAPITAL INVESTMENT PLAN - TAX SUPPORTED PROGRAM**

FROM: Dan Labrecque, Chief Financial Officer

OBJECTIVE

The objective of this report is to provide Council with an overview of the issues, challenges and potential actions relating to the financial sustainability of the corporation's long term non-growth tax supported related capital program.

REPORT HIGHLIGHTS

- Current tax supported reserves and budgeted contributions to reserve will not sustain ten year capital plan.
- Finance oversight of corporate capital plan will be more of a portfolio focus.
- First step to achieving financial sustainability will be a proposed one per cent tax rate increase for capital financing purposes. This with annual incremental one per cent increases will generate approximately \$400 million in needed funding over the next ten years.
- Continued focus on advocacy with provincial government for uploading of social costs as an ultimate target with elimination of provincial under funding as the interim measure.

DISCUSSION**1. Background**

During the 2007 Budget process staff brought forward a report in regards to the sustainability of our longer term capital financing program. In that report a number of emerging issues were identified that warranted ongoing review. They included:

a) Impact of Growing Construction Costs

Over the last three to four years the cost of construction has increased significantly due to a number of global and local issues, such as:

- i) **Demand for Steel** has been high due in large part to major construction growth in Asia, especially in China, where its focus on preparing for the 2008 summer Olympics and the 2010 World Exposition has placed steel in high demand. This demand has now begun to moderate but base prices remain high.
- ii) **Price of Oil** has hit historic highs. As a result, the price of asphalt remains high.

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- iii) **Reconstruction of the Gulf Coast** following Hurricane Katrina continues. This has had significant impacts on supply.
- iv) **Tight labour markets conditions remain in Canada.** Just last month, Statistics Canada reported unemployment levels had dropped below six per cent for the first time since 1974. Further impacting this trend is the significant increase in demand for capital works driven by the economic expansion in Alberta and by programs such as the Federal Gas Tax which has provided significant new funding for construction purposes.

Overall capital inflation is running at multiples of the general inflation level. In order to maintain oversight on these trends a series of indicators are now tracked on a regular basis through the Peel Data Centre. Appendix II reflects a snapshot of the current indicators tracked as part of the "Dashboard of Economic Indicators" which can be accessed through the Peel Web Site at peelregion.ca/finance/dashboard-eco/ under the "Capital Plan Price Trends" tab.

b) Changes to Capital Plan

Besides the impact of construction prices, Peel's capital program continues to grow for a number of other reasons:

- i) **Greater Emphasis on Dealing with Traffic Congestion.** Growing citizen frustration with gridlock has resulted in growing emphasis on enhancing the ability of the road network to meet consumer needs.
- ii) **Ageing Social Housing Inventory.** While technically related to provincial downloading, the state of good repair of our social housing inventory is significant on its own merits. Council is well aware that the provincial transfer of these assets, valued in excess of a billion dollars, was executed with totally inadequate replacement reserves. Many of these facilities, home to over 25,000 Peel citizens, are approaching the stage in their life cycles where major investments will be required to renew those assets so as to ensure an appropriate quality of life for their residents. While the Region has managed its liability well, by reinvesting mortgage savings into replacement reserves and helping providers develop asset management plans, the reality where even the Region's reserves will be fully expended is nearly upon us. By the end of the current ten year planning horizon, very few if any providers in Peel will have any reserves to meet capital maintenance needs and likely all will be depending on the Region to support them.
- iii) **Development Charge Shortfalls.** Under the existing legislation, development charge contributions have been limited to the extent of the average service level achieved over the last ten years. Growth in programs like Long Term Care, Paramedic, Day Care and Housing can not be fully met by development charges. As such, the property tax base must absorb any shortfalls.
- iv) **Provincial Downloading.** While inter-related with the above noted points, it must be noted that the government does not provide adequate funding for programs that it is supposedly cost sharing. As has been noted, the Ministry of Health and Long-Term Care and Paramedic Services will not provide any financing support to the Paramedic capital program. As such, the property tax

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base must pick up almost all the costs of the proposed \$50 million facility master plan. In actual fact, as a result of development charge ten-year service level caps, the property tax program is required to absorb almost 92 per cent of the plan. If artificial caps were not in place, property tax would likely only have to absorb a value in the range of 25 per cent.

Social Housing has experienced first hand the impact of unfair cost sharing principles. Recent request for proposals, with respect to the Affordable Housing Program, have seen average unit costs increases over 30 per cent. However, we have seen no change to provincial funding. This means that the Region is required to either absorb the difference in order to have some impact on the waiting list or reduce significantly the quantity of housing stock being added to the community.

A more recent "downloading" issue has been the funding of GO Transit. While this program is clearly owned and operated by the government, it continues to insist that 416/905 (the GTA and Hamilton) municipalities pay one-third of the growth capital plan, even if development charges cannot raise these funds. Should the provincial government prevail in this matter, property taxes could be called upon to fund in the order of \$8-12 million annually for what really is a provincial program.

c) Current Budget Constraints

As noted in the Chief Financial Officer's presentation to the July 5, 2007 Regional Council meeting titled "Budget Pressures 2008 and Beyond", during the 1990's the Region had experienced almost a decade of fiscal success insofar that it managed to deliver annual budgets at a modest to nil tax impacts while managing the overall impact of growth. Subsequent to the significant impacts brought on by the previous provincial government in 1998 through its Local Services Realignment ("LSR") initiative, Peel's budget has come under increasing pressure. Since the 1998 LSR program was initiated, Peel's total budget will almost have doubled – draft 2008 plan in the range of \$1.4 billion. One strategy that Council utilized in managing the impact of mandated program increases was to restrain the growth in reserve contributions. At a time where capital replacement costs have been growing at multiples of inflation, the Region's capacity to set aside funds has been eroded over time. In fiscal 2000, total net contributions to reserves represented about 16.8 percent of the entire corporate budget. For fiscal 2007, this has decreased to 10 per cent. The tax supported programs on their own reflect a position closer to 5 per cent. This level of funding cannot sustain the longer term direction of the capital plan and more specifically, the corporation's state of good repair budget plan.

The largest single inhibitor to maintaining reserve balance positions has been the impact of provincially downloaded programs. It is critical to note that during the 1990's Council was able to maintain very stable tax rates, eliminate the need for debt as a source of capital financing and build up reserve balances. The previous provincial government committed that the changes in funding and responsibility arising from the Local Services Realignment initiative in 1998 were going to be revenue neutral. The reality has been that the downloading has continued unabated resulting in increased pressures on tax rates. One of the tactics that council has utilized in balancing the impact of tax rates and citizen needs has been to hold back on increases to reserve contribution levels and at the same time increase the use of contributions from reserve to balance program needs.

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Over the spring and summer as part of the Development Charge Update process, a number of reports were presented to Council in regards to the growth related program and the impact on development charge rates. That work culminated with the adoption of a new Development Charges By-law on October 4, 2007. This report attempts to provide Council with an overview of the status of tax supported program reserve positions as we begin to review the implications of the 2008 to 2017 Capital Plan. Reserve funds that have been established to track provincial flow through such as Best Start and gas tax programs have been excluded from this report given that they reflect administrative tracking of these funds and that they are not really discretionary funds available for general use by Council.

This report also excludes any analysis of reserves for utility rate supported programs since they will be subject to a separate report at a later time.

This report attempts to provide a broader overview of the current state of tax supported reserves in Appendix I. Section 2 of this report will undertake to present the longer term implications that the 2008 to 2017 capital plan will have on future budgets and will propose a different approach to the funding of the plan which should ameliorate the overall cost of the program while providing Council with ample opportunity to continue its advocacy, along with all Ontario municipalities, for a renewed cost sharing program with the provincial government. This is followed by a discussion on the development of a Corporate Asset Management Strategy in Section 3 of this report. This strategy will enhance Council's ongoing understanding of the status of the condition of the corporation's diverse infrastructure needs.

2. Longer Term Capital Sustainability Strategy

At the time of the preparation of this report the 2008 to 2017 capital plan was still under development, however, the preliminary assessment suggests a tax supported plan in the range of \$2.5 billion. After optimizing the component that is recoverable from development charges and other external sources, such as grants and other municipal recoveries, the net funding requirement is approximately \$1.5 billion.

If existing contributions were not to change over the course of the ten year planning horizon, the impact on our finances would be significant. Overall, reserve balances would be essentially eliminated, which would severely impair our ongoing flexibility. Furthermore, we would require an additional \$300 million in debt to meet the obligations of the plan.

Traditionally, each program budget has incorporated capital financing requirements within the context of their individual business plans. That protocol has served the Region well over the last few decades. Full accountability for program costs has provided a significant incentive to program managers to commit to continuous improvement as a means of reallocating budget room to meet growing needs.

However, recent changes in the environment has made it increasingly difficult to manage effectively in this manner. For example:

- Capital inflation rates experienced over the last few years have been "multiples" of regular inflation. As such, it has become increasingly difficult to estimate capital costs when developing budgets and in order to provide flexibility; it has become the practice to budget larger contingencies within capital projects.

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- Council decisions to increase service levels – i.e. additional long term care centre, increased paramedic service hours.
- Impact of provincial downloading and underfunding, including the impact that external organizations, such as the Conservation Authorities have on design criteria or regional roads.

As well, dealing with capital financing strictly on the basis of individual program needs also has the downside that one tends only to deal with programs with funding deficiencies. Those that happen to have a relatively more stable funding profile tend to maintain those balances for needs in outlying years.

In approaching the 2008 budget process, staff reviewed the state of the reserves and the proposed 2008 capital plan to develop an understanding as to what additional levels of funding would be required if the assessment was made simply on the basis of emerging program needs.

a) 2008 Budget Impact – Program specific scenario

When reviewing the state of program reserves the two largest issues facing the Region this year are Roads and Paramedics. (A more complete analysis of reserve status by program is contained in Appendix I.)

- Roads** has faced significant cost pressures over the last few years. The ten year plan calls for \$290 million in spending, with \$26.2 million planned for 2008. Against this need, the reserve contributions are only \$15.3 million. While there are reserve balances remaining, recent tender experience suggests that a significant contingency should be maintained. Based on previous practices of ensuring that funding was in place when Council approves a project, the 2008 current budget would increase by about \$10 million for the Roads Capital program.
- Paramedic's** proposed first phase of the facility plan is the main driver behind the need for \$22 million in reserve requirements. After offsetting reserve funds that were set aside specifically for the facility plan, the 2008 budget would still require additional funding in the order of \$16 million.

When taking into account the estimated \$26 million for these two programs and a host of smaller adjustments, the overall budget impact for capital could top \$28 million, which would translate into a 4 per cent tax increase.

b) 2008 Budget Impact – Portfolio scenario

The obvious concern about the above noted scenario, besides the significant impact on tax rates, is that this decision would not be made with any longer term view in mind. For example, by increasing taxes to meet Paramedic needs, it is quite likely that no further advocacy would be undertaken to bring the matter of provincial under-funding to the level that is required to impact meaningfully the cost that the program has on taxpayers.

It is proposed that the 2008 budget undertake a change in direction. Specifically, the primary focus will shift to one of managing the capital financing program as a "portfolio" and not as scores of individual programs. With a portfolio process, reserve adequacy is assessed at a Regional as opposed to individual program level. This allows healthy reserves to offset program areas with weaker reserve levels before overall reserve contributions levels are increased. This approach also recognizes that reserve

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requirements can be driven by forces that could contradict each other (i.e. inflationary versus recessionary). In such cases a portfolio approach would facilitate a "smoothing out" which would help to somewhat ameliorate overall reserve contribution requirements. In addition a portfolio approach will recognize that not all program contingencies will be required. By applying a regional perspective to reserve analysis, we are able to moderate the overly conservative contingency planning which is incorporated when programs are evaluated in isolation of each other. This provides additional assurance to the public that programs are funding appropriate but not excessive reserve levels.

This shift on its own will not generate the answers to all the "questions".

Other key components of the overall capital planning renewal that will be required include:

- As part of the overall Common Purpose framework, the Corporate Planning Process is undergoing a fulsome review.
- Corporate Asset Management Strategy is undergoing development. Staff realignment process is underway in Finance to resource this key strategic initiative, which is described in more detail in section 3 of this report.
- Provincial/municipal review is anticipated to address, in some fashion, the overall downloading of provincial costs on the property tax base. Results of the review may influence overall direction of the capital financing strategy.
- Review of other options to manage the broader Social Housing issues.
- Identification of key issues well in advance of need, so as to explore fully the total impacts of those decisions. For example, while council has directed staff to incorporate an additional long term care centre into the ten year planning horizon. Staff have already commenced research of the issue with the LHINs and will bring back a mix of service options including a new facility. Traditionally, this direction would have been cause to start raising reserve balances to pay for the transaction.

Overall, more funding is required. Balancing tax impacts and cash flow needs will be a challenge. With existing reserve balances **it will be proposed in the 2008 Current budget to include a one per cent tax increase for capital financing purposes. This increase, with subsequent annual incremental one per cent tax increases, will support the capital plan by adding almost \$400 million over the next ten years.** This first step along with the diligence required to address the above noted points will stand the corporation well in sustaining its tax supported infrastructure. In the initial stages, some programs may require enhanced level of internal financing. Enhanced reporting to management and Council will compare annual progress against preset portfolio targets.

It is also proposed that interest income on stabilization reserves be pooled and utilized along with annual budget increase to meet specific program needs through redeployment. As has been the practice, any such redeployments would be reported to Council as part of regular financial updates.

3. Corporate Asset Management

At present, the Region has a number of processes and systems to assist in managing its diverse infrastructure requirements. One of our challenges is that there is no broader means to pull all these processes together. The Corporate Asset Management initiative was actually identified through the strategic planning process as a keystone to our longer term asset and reserve management sustainability. The initiative was founded as a collaboration

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between the previous Housing, Public Works and Finance departments. As an integral component of the recent corporate reorganization, the Finance Department was assigned lead role in the development and oversight of a corporate wide asset management strategy.

Benefits of this initiative include:

- More accurate long-term forecasting of infrastructure needs and funding requirements;
- Comprehensive reserve management following a portfolio approach;
- Setting achievable and cost effective service standards, measuring and reporting performance;
- Understanding and measuring the condition, risk, performance and criticality of our assets;
- Providing both management and Council with an objective overview of program proposals to maintain an effective state of good repair for the Region's existing infrastructure;
- Operating with greater transparency;
- Optimizing infrastructure through effective maintenance and demand management practices;
- Reducing and managing risk;
- Enhancing the Region's ability to meet the need for developing a sustainability plan, as required under the conditions of the Federal Gas initiative; and
- Providing synergies with the Public Sector Accounting Board's ("PSAB") current directive to incorporate the accounting for tangible capital assets into the financial statements (by 2009) and the proposed directive to report on the condition of tangible capital assets.

The development of a total asset management system is envisioned as a three phase approach that will take many years to finalize and implement. One factor in the timing is the desire to align with other initiatives currently in development. This will lever efforts and recognize meaningful cost savings. It also recognizes that technology enhancements will be required and the development and phasing of them will be a multi-year effort.

a) Phase 1

The first phase's primary objective is to develop the broader strategy. One of the key outcomes is the development of a management reporting tool that assesses the current and future state of Peel's infrastructure and the financing strategies required to support the sustainability of the service delivery capacity of that infrastructure. This phase's estimated duration is approximately two years.

b) Phase 2

The next stage will be engaged with supporting all program areas in developing and refining asset management strategies for their particular situations. The outcome of this phase will be a series of strategies identifying processes, tools, standards and best practices suitable to Peel to meet the ongoing needs of each group of particular assets. This phase will take upwards of another two to four years. Higher priority areas will be addressed first.

c) Phase 3

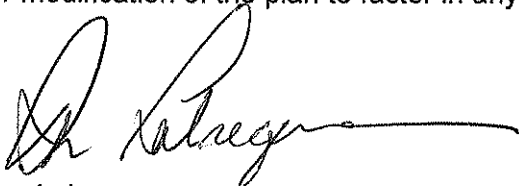
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The final stage will simply implement and refine the asset management strategies as identified in Phase 2. As previously noted there are numerous existing processes and practices in place. Phase 3 may not be required if Phase 2 work validates and verifies the existence of good asset management practices.

While the operational management of the Region's significant investment in public infrastructure will continue to be vested with the program directors, the Finance Department's role is that of oversight and coordination. Standards will be established, measured and reported to council and management on a regular basis. Council and the public will have another source of quality assurance and quality control to support their decision making in regards to budget allocations for infrastructure sustainability. The direction that PSAB is favouring be incorporated as a value add public reporting initiative, is one where annual "report cards" are generated which compare Council approved standards with actual objective condition assessments for all major asset classes. Appendix III represents PSAB's Statement of Principles which has been broadly circulated for comment by municipal finance and public sector accounting professionals.

CONCLUSION

The Region's ten year capital plan for the development and maintenance of its tax supported programs is now well in excess of two billion dollars. Existing reserve contribution levels can not sustain the plan. While enhanced levels of funding are required, the ultimate management plan to effectively control the cost of the plan must incorporate many tactics. Continued advocacy with the provincial government for a fairer and more equitable distribution of social costs is a mandatory part of the broader plan. Initiatives such as the Corporate Asset Management Strategy will bring a rigour and more consistent measurement and reporting on our activities. While these initiatives run their course, it is proposed to address the larger funding dynamic in a way that balances longer term trends and needs with the ability to plan for the financial impacts. To this end an initial strategy calls for an annual one per cent tax increase for purposes of managing the overall tax supported capital plan in a broader portfolio context. The proposed 2008 Current budget will include \$7 million in new funding as the first step. Over the course of the next ten years this action could deliver in the range of \$400 million in new funding, albeit a majority in the last five years of the horizon period. Annual reporting will allow for modification of the plan to factor in any significant changes in the overall environment.



Dan Labrecque
Chief Financial Officer

Approved for Submission:

D. Szwarc, Chief Administrative Officer

*For further information regarding this report, please contact
the author at extension 4258 or via email at dan.labrecque@peelregion.ca*

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Program Overviews

a) Environment, Transportation and Planning Services (ETPS)

The new Environment, Transportation and Planning Services Department has programs which impact both tax and rate supported programs. Only the tax supported programs are presented below.

i) Waste Management

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Working Fund	\$10.9M	\$0M
Capital	\$88.2M	\$0M
Replacement	\$13.4M	\$0.6M
Abatement	\$20.4M	\$0M
Total	\$132.9M	\$0.6M

The program's proposed ten year capital plans calls for \$114. 3 million in reserve financing to support the Long Term Waste Management Strategy. Overall program cash flow forecasts suggest a residual reserve balance in 2017 in the range of \$30 million, or almost 78% less than the current balance.

Analysis suggests:

- Ongoing abatement program for closed landfill sites will continue to require ongoing funding. Original concept of abatement reserve which still holds true was that, by and large, interest on the abatement reserve would fund majority of post closure costs well into the future. Most of the 2017 residual reserve balances reflect the landfill post closure abatement reserve.
- State of Good Repair costs will continue to rise as existing and planned infrastructure ages. Existing reserve contributions will have to be adjusted to ensure operations continue to be efficient.
- The reserves will not be able to support any major new program changes, without new or additional sources of funding.
- Previous decisions by the provincial government to eliminate development charges as a source of funding for this program area, transfers a significant burden onto property taxpayers.
- The dedicated reserve for the BraeBen Golf Course has not grown as previously expected due to lesser than projected usage of the facility. Future state of good repair needs may not be covered by this reserve.
- The stabilization reserve is still being utilized to phase in the tax impacts of closing the Britannia landfill site in 2002. The 2008 budget will require a further \$1.8 million from this reserve to maintain the originally scheduled phase in plan. It is anticipated that this will likely be the last draw from the reserve, with the final budget impact of \$1.5 million being realized in the 2009 budget.

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ii) Transportation

Transportation Services can be subdivided into two major program areas – Roads and Transhelp.

(a) Roads

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Winter Stabilization	\$5.3M	\$0M
Capital	\$20.6M	\$15.3M
Replacement	\$9.5M	\$3.6M
Total	\$35.4M	\$18.9M

The proposed ten year capital plan requires in the range of \$290 million in reserve financing in order to fulfill the objectives of the plan, which are primarily related to maintaining the state of repair of equipment and public infrastructure. Without any adjustments to the program, cash flow forecast suggest a funding deficit in the range of \$160 million by 2017.

Analysis suggests:

- The overall shortfall may be understated should recent contract price increase trends continue.
- While fleet reserve contributions have kept pace with fleet needs, building and equipment reserve contributions have traditionally only reflected minor levels of asset management investment, as is the case when facilities are relatively new. Aging facilities will likely require enhanced level of funding in the future.
- ***Overall, current budget contributions for road infrastructure will likely require, at a minimum, a doubling over that which currently exists, over the forecast period.***

(b) Transhelp

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Working Funds	\$0.3M	\$0M
Replacement	\$1.9M	\$0.4M
Total	\$2.2M	\$0.4 M

Over the last few years, most new capital needs, both for growth and the state of good repair are well managed through the provincial and federal gas tax funds currently being received. The total ten year plan calls for \$21.6 million in new and replacement works and generally a combination of existing budget allocations and senior level transit funding provides for some sustainability of this growing program.

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Program risks include:

- Near term cessation or reduction in existing levels of provincial and federal gas tax would require offsetting increases in tax or fee sources to maintain service enhancement commitment.
- Longer term horizon suggests a potential “crowding out” effect should gas tax revenue flows not be able to meet both ongoing growth and replacement programs.
- Cessation risk includes provincial positioning in regards to the funding of GO capital program costs by Peel.

iii) Planning

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Working Funds	\$0.5M	\$0M
Capital	\$1.3M	\$0.25M
Total	\$1.8M	\$0.25M

Unlike the other ETPS programs, the Planning program is not focused on the acquisition of tangible capital assets. The primary use of reserves in this program is to support Council attendance at Ontario Municipal Board (OMB) hearings, where the Region has an interest, and to fund various studies required by Council in the execution of its Regional planning responsibilities. The proposed capital plan sets out an estimated \$4.8 million for studies and potential contingencies. Current reserve balances and contribution levels will not support this level of investment without at least a doubling of reserve contributions.

b) Human Services

The Human Services department has maintained reserves for both operational and capital program needs.

i) Ontario Works (OW)

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Working Fund	\$18.3M	\$0.08M
Grants	\$0.5M	\$0M
Replacement	\$0.3M	\$0.37M
Capital	\$0.0M	\$0M
Total	\$19.1M	\$0.45M

The Ontario Works program has been hampered by provincial protocols that do not support planned reserve contributions. Any reserves set aside are then achieved via 100 per cent funding by the tax base. When the existing financial control by-law was established in the mid-1990's, one of the key principles was

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one which sought to review options to “reserve” operating surpluses to offset future budget pressures. It is for this reason that program surpluses in the OW program in the late 1990’s were set aside for the eventuality that an economic downturn would cause sudden economic strain on the Regional Budget due to rises in caseload.

While the economy has been generally very sound, the reserve has been utilized to defer some tax impacts. The 2008 budget incorporates a \$1.5 million contribution from the stabilization reserve as part of a phase in program approved by council in 2002. It is anticipated that the final element of the phase in will be realized in fiscal 2009 with the final \$1.8 million budget impact. Lack of capital reserves in this program and associated lack of capital spending support from the provincial government has resulted in this reserve being utilized to support the Shelter program. The 2008 budget includes a provision for the replacement of the Mavis shelter, which will use this reserve as the only viable source of funding available to the program.

Overall, analysis suggests:

- After the funding of the Mavis Shelter replacement reserve and the final installment of the 2002 tax rate management initiative, the residual balance of the stabilization reserve will only be able to provide transitional support during an economic downturn. This is significantly less coverage than was originally intended when the reserve was established. Future program surpluses, when they arise, should be used to replenish this reserve.
- State of good repair principles will dictate significant increased contribution levels for the Region’s shelter program.

ii) Children’s Services

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Replacement	\$0.9M	\$0.6M
Capital	\$0.0M	\$0M
Total	\$0.9M	\$0.6M

The Children’s Services reserve program has been primarily focused on managing the state of good repair of the regionally owned day care centres. With the addition of the Lancaster PLC centre in Malton in 2007, we now have twelve centres. Budgeted reserve contributions have barely kept pace with program needs and will likely need ongoing increases to meet longer term infrastructure sustainability.

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iii) **Social Housing**

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2008 Budget Contributions
Replacement	\$49.2M	\$2.5M
New Capital	\$27.2M	\$7.0M
Working Funds	\$6.4M	\$0M
Total	\$82.8M	\$9.5M

The above noted reserve contributions were originally funded by redirecting mortgage savings, realized at renewal. The 2008 Budget proposes a shift in these reserve contributions to reflect Council's intent to prioritize adding new assisted housing stock to deal with the growing waiting list. The 2007 plan presented an allocation that is fundamentally reversed from the proposed 2008. The 2007 budget suggested that banking funds for ultimate infrastructure renewal was the higher priority.

As Council is well aware, its obligations under the *Social Housing Reform Act* extend to financially supporting all prescribed housing providers. One of the issues that Council has been advocating for, since the downloading of the program, is for the federal and provincial governments to assume the unfunded maintenance liabilities. Projects were turned over with reserve balances woefully inadequate to sustain longer term state of good repair.

Over the period that the Region has been given operational oversight, it has been able to redirect savings from reduced mortgage costs to the major maintenance reserve. To date \$49 million has been accumulated in this reserve. While a positive step, mortgage rate renewal trends suggest that we have "bottomed" out and will likely see some upwards bias in future renewals.

Analysis suggests:

- Due to rising construction costs, and no recognition of that phenomenon by the senior level governments, Council targets for new housing projects, required to have any meaningful impact on waiting lists, are at risk without more substantive investments.
- **Lack of leadership by the provincial government in dealing with the impact of aging infrastructure may translate into a significant shortfall for council in the order of \$150-200 million by the end of the ten year forecast period.**

One interesting shift in senior government funding is that of migrating away from front end grants to one where contributions are flowed to us over periods in the range of 15 to 20 years. While providing some funding for new programs, the onus on the "borrowing" for construction and delivery of the program is shifted to Council. This suggests growing levels of "internal loans", which at current levels of approximately \$50 million are likely to multiply significantly over the term of this ten year capital plan. This will likely have an impact on overall corporate liquidity and may warrant accessing external borrowing sources to sustain the program.

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c) Health Services

All three branches of the Health Services department have capital sustainability issues to various degrees.

i) Public Health

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Replacement	\$2.6M	\$0.25M
New Capital	\$0M	\$0M
Working Funds	\$1.3M	\$0M
Total	\$3.9M	\$0.25M

The Public Health capital program is focused primarily on managing leasehold facilities for staff and clinics and the acquisition and maintenance of management information systems. While growth in Peel requires expanded office and clinic space, traditionally the Ministry of Health and Long-Term Care and Paramedic Services has not adequately funded either operating or capital requirements in Peel. The province is providing limited operational growth funding (5 per cent each year for the past two), which in light of historical funding shortfalls for growth, make it a challenge to add and expand service when existing services are underfunded. Given the current state of under funding from the province, the short term capital investment needs of the program are generally modest in their scope. In the mid to long term horizon, there may be some challenges to expand the program's clinic spaces in such a manner as to meet the community's needs.

ii) Long Term Care

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Replacement	\$(2.6)M	\$3.2M
New Capital	\$0M	\$0M
Working Funds	\$9.0M	\$0M
Total	\$6.5M	\$3.2M

As a result of the recent addition of two new long term care centres, the Long Term Care reserves are in a net borrowing position, as noted above. Besides this modest internal borrowing position, the program has a further \$10.3 million in internal loans, reflecting the need to have borrowed the funds to finance the construction and then receiving the province's "share" over 20 years, based on receiving a per diem of \$10.35 for each bed. This loan will be paid back with additional provincial grants. It should be noted that while the stated cost sharing rate is 50 per cent, the capitalized value of the provincial per diem grant was less than 20 per cent of the final costs of the new facilities.

Barring any unforeseen major maintenance issues, it is anticipated that the current funding plan will eliminate the noted internal funding position and a

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significant portion of the current renovation plan at both Sheridan Villa and Peel Manor.

Current Working Fund balances will largely be required to minimize any tax rate pressures that result from Council's decision to continue operations, at a reduced level, at Sheridan Villa during its current major renovation program.

The single largest challenge for the Long Term Care program is the funding of a sixth long term care facility or some other form of community infrastructure support that the community will be requiring over the scope of this ten year capital planning horizon. A future facility would replace the ninety-four beds the community lost through the redevelopment of Sheridan Villa and the balance would be an offset for growth in an ageing population. The proposed ten year plan incorporates a "marker" for a facility in the range of \$50 million. Development Charges are anticipated to offset approximately one-third of these costs. Provincial funding is subject to Local Health Integrated Network (LHIN) planning and as Council is aware, the Region must collaborate with two LHINs that currently cover the Region of Peel. Staff are continuing to review models and options to support Council's decision making on this issue. Based on provincial support, realized in the last expansion of the program, we would only receive provincial funding in the range of \$5-6 million, leaving Peel to finance the balance of up to \$30 million.

As previously reported to Council, it could be very conceivable to fund this program and its anticipated \$8 million net operating budget by adding incrementally a million dollars to each of the next eight to nine years' budgets. However, at this point staff are proposing that it is more appropriate to continue to work with the two LHINs to garner formal provincial support and hopefully more adequate funding. At the same time, we are exploring other service models that might be delivered at a lower overall cost.

Analysis suggests:

- Existing financial plan will meet the program's needs, subject to inflationary adjustments.
- No funding currently exists for additional service infrastructure, in the form of a sixth Long Term Care facility.
- Managing this regional program in a two LHIN environment is challenging.

iii) Paramedic and Emergency Services

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Replacement	\$3.2M	\$2.9M
New Capital	\$4.8M	\$0M
Working Funds	\$0.7M	\$0M
Total	\$8.7M	\$2.9M

CAPITAL INVESTMENT PLAN - TAX SUPPORTED PROGRAM

This program has suffered significantly from provincial under funding. A recent report to the Emergency and Protective Services Committee (EPSC) has provided Council with the particulars of a \$50 million facility master plan. For all intents and purposes, there will be no provincial funding available to take this critical step in ensuring the long term viability for this essential public service. The 2008 Capital plan proposes that the initial stages of this plan be funded through internal borrowings. Continued advocacy with the provincial government as well as updates to the *Development Charges Act* is essential in achieving some appropriate level of funding. As it currently is structured, the property tax base is exposed to funding over 90 per cent of the facility plan. Traditionally, this would suggest increased reserve contributions, in the order of five million dollars, annually to fund this program over a ten year period.

Besides the noted commentary on the facility master plan, the analysis suggests:

- That as a result of growth, current level of reserve contributions will not sustain the ongoing fleet and equipment replacement program.
- Fleet and equipment reserves will generate a potential deficit in the range of \$17 million over the forecast period, without meaningful changes to provincial financing or tax based funding.

d) Regional Internal Support Services

This program area covers the overall service needs of the three support departments (Finance, Corporate Services and Employee and Business Services), as well as Council and the Executive Office.

As of August 31, 2007, the program had the following reserve profile:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
Replacement	\$33.5M	\$5.6M
New Capital	\$19.5M	\$4.2M
Working Funds	\$2.1M	\$0M
Total	\$54.1M	\$9.8M

Technology related programs account for 60 per cent of the existing reserve balances. A further 23 per cent relate to existing facility reserves. The majority of the balance relates to the \$8 million in Energy reserves that we have been able to build up over the last four years as a result of rebates coming from the energy bill oversight program. Working fund balances reflect previous year surplus positions that have been carried over and the reserve for the post retirement allowance for Council members.

The analysis suggests:

- Current technology infrastructure positions can be managed well over the horizon period.
- New technology investments, on the other hand, may pose a challenge. New enterprise wide systems bring a significant cost with them.
- Energy fund likely not to be sustained through utility bill verification savings, as utilities enhance their efficiencies. Proposed 2008 budget will reduce

CAPITAL INVESTMENT PLAN - TAX SUPPORTED PROGRAM

contributions to Energy reserve by 50 per cent or \$1 million, due to declining levels of verification savings.

- Facility maintenance costs built into budget at generally low levels. Decision to fully fund 10 Peel Expansion Project (PEP) from existing reserves has all but eliminated general government capital reserve flexibility. Budget constraints have effectively eliminated reserve contributions for new general government initiatives.

e) Police Services

The status of Regional reserves that have been established for police needs was not the subject of detailed review at this point in time. Generally, Finance staff review details of the proposed capital program and the impact on reserves with staff from both the Peel Regional Police and the Caledon OPP detachment, in consultation with the Town of Caledon Treasurer. At the date of the preparation of this report, pre 2008 budget discussions have not been conducted. As Council is aware, the Peel Regional Police Service business plan falls under the oversight of the Police Services Board and Council. Traditionally, the capital and reserve plan has been well thought out and is based on sound underlying planning for fleet, facilities, technology and other special policing needs.

As of August 31, 2007, the program had the following reserve profile for the two police services:

Reserve Type	Uncommitted Balance	2007 Budget Contributions
PRP - Infrastructure Needs	\$56.4M	\$7.5M
PRP – Working Funds	\$11.5M	\$0M
OPP – Infrastructure Needs	\$6.7M	\$0.4M
OPP – Working Funds	\$1.5M	\$0M
Total	\$76.1M	\$7.9M

f) Other Corporate Tax Based Reserves

In order to understand the overall corporations reserve status the following section outlines other corporate tax based reserves:

- Assessment Working Funds** - As of August 31, 2007, \$7.7 million is on deposit in this reserve. The reserve is used as a clearing account for the Region's role as "banker" in dealing with tax policy matters between the Region and the three area municipalities. The reserve also serves as a stabilization account to assist in managing the impacts of tax bill write offs as undertaken by the area municipalities.
- Risk Management** – As of August 31, 2007, a total of \$21.6 million has been established in a number of reserves to support the Region's liabilities in regards to insurance, employee benefits (including post retirement benefits) and Workplace

CAPITAL INVESTMENT PLAN - TAX SUPPORTED PROGRAM

Safety Insurance Board (WSIB). Actuarial reviews are undertaken on a regular basis, the results of which are incorporated in the notes to the annual financial statements. At this point in time, post retirement benefits are not fully funded.

- iii) **GO Transit** – As of August 31, 2007, \$1.8 million remains in the GO reserves. As Council is aware, the matter of GO Transit funding has been the subject of many reports over the last three years. Currently, Council's position is to restrict funding to GO programs to the amount of development charges it collects under the existing DC By-law, established in 2001 for this purpose. The provincial government's position is contrary to council's. Specifically, it assumes that Regional Council will fund the full component of the GO plan, which based on the most recent draft background study would include non-growth funding in the range of \$10 million per year.
- iv) **Hospital** – As of August 31, 2007, \$11.6 million remains in the Hospital reserve. While all principal balances collected through lot levies and development charges have been assigned and in most cases paid out to Peel hospitals, \$11.6 million of interest earnings have accumulated over the last decade, largely due to delays in the hospital approval, development and construction processes. There have been discussions with respect to assigning these funds to the acquisition of land for the next Peel based hospital, however, introduction of the LHINs has introduced an additional layer of complexity to the resolution of this fund. Given that the funds were initially raised on the basis of "beds", there is logic to assign the funding, as a back up plan, to Peel's Long Term Care program.
- v) **Stabilization/Contingency** – As of August 31, 2007, two separate reserves exist to support contingency requirements of the organization. There currently exists \$19 million in uncommitted reserves relating to funding the Pooling program. This program, as council is aware, is to be phased out over the next six years. As such, the need for protection from impacts of GTA wide economic downturns has significantly dissipated. Along with this fund, there exists the corporation's general working fund reserve of \$25.2 million. Interest income on both these reserves has been utilized to support other reserve management adjustments on an annual basis. This has avoided budget pressures in the range of \$2-2.5 million over the last three years.

It is proposed that the stabilization/contingency reserves form the foundation for a go-forward longer term capital sustainability strategy described in greater detail in Section 2 of this report.

CAPITAL INVESTMENT PLAN – TAX SUPPORTED PROGRAM

Capital Plan Price Trends

Major influences on commodity prices - First Quarter 2007

The major influences on the price of construction inputs in early 2007 remain similar to those which influenced prices in 2006. Broadly, they reflect market specific changes in demand supply conditions, geopolitical developments and local economic changes. More specifically, the major influences for 2007 to date include the following factors:

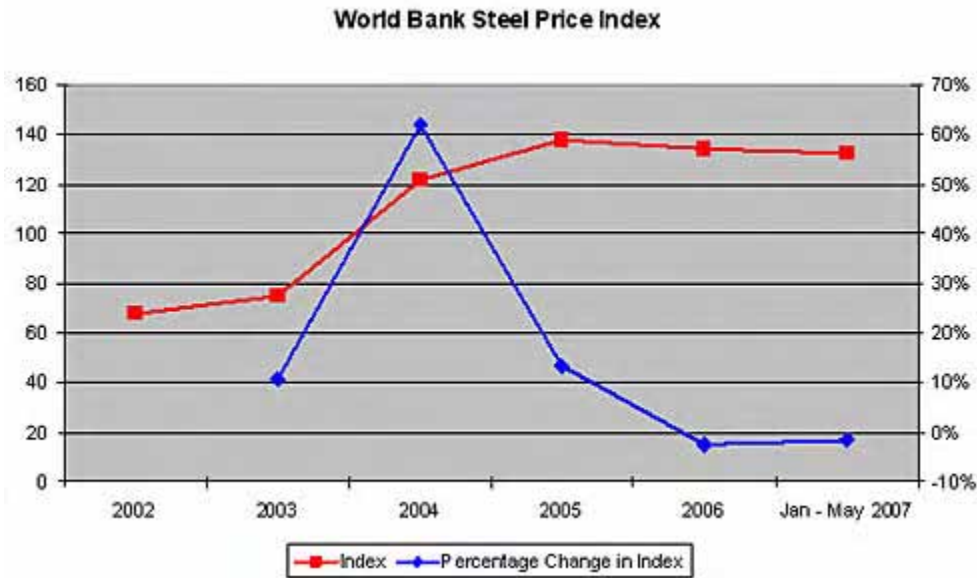
- **Demand for steel remains high keeping prices at a relatively high level** (due in part to major construction projects in developing countries such as India, Thailand and especially China, where preparations are on the way for the 2008 Beijing Olympics and the 2010 Shanghai World Exposition and where residential construction activities remain buoyant).
- However, **China has increased its steel production capacity and has therefore reduced its demand for steel on the international steel market.** In March, China set a monthly record by producing 40.16 million tons of steel, according to that country's National Bureau of Statistics.
- **The price of crude oil on the international market remains elevated given geopolitical uncertainties around the world.** As a result, the price of asphalt remains high.
- **Reconstruction of the Gulf Coast continues.**
- **Tight labour market conditions remain in Canada.**

TABLE 1: PERCENTAGE CHANGES IN THE PRICE OF SELECTED CONSTRUCTION INPUTS											
	ENERGY			MAJOR INPUTS		OTHER INPUTS					WAGES
	NCPI	Crude Oil	Nat. Gas	Steel	Asphalt	S & G	L & W	Pipe etc.	Port. Cmt.	Rdy. Mix	Wage rts.
2001	4.4%	-14.6%	27.9%					5.3%			2.6%
2002	1.8%	0.6%	-21.4%			3.8%	-0.6%	-2.4%	2.5%	1.6%	3.2%
2003	3.7%	19.2%	26.7%	10.8%	10.3%	3.3%	-3.9%	0.9%	1.3%	0.4%	2.6%
2004	6.6%	33.2%	12.3%	62.0%	-7.7%	3.6%	12.0%	2.8%	3.0%	2.8%	3.1%
2005	5.3%	36.3%	22.9%	13.5%	2.9%	3.4%	-8.5%	9.1%	2.6%	3.4%	3.1%
2006	6.0%	16.9%	3.3%	-2.5%	42.2%	14.2%	-5.8%	9.5%	3.7%	5.7%	2.7%
2007*	6.9%	-13.1%	-3.6%	0.0%	23.8%	n.a	n.a	n.a	n.a	n.a	n.a

* latest available information

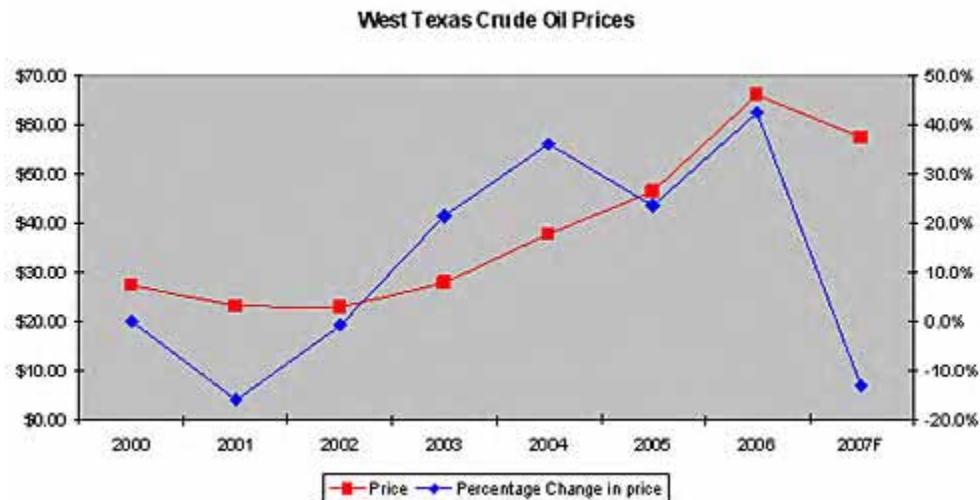
APPENDIX II
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CAPITAL INVESTMENT PLAN – TAX SUPPORTED PROGRAM



Source: World Bank

- Demand for steel remained strong in 2007 keeping the price at elevated levels.
- However, the rate of change in price tempered as China increased its domestic steel production.



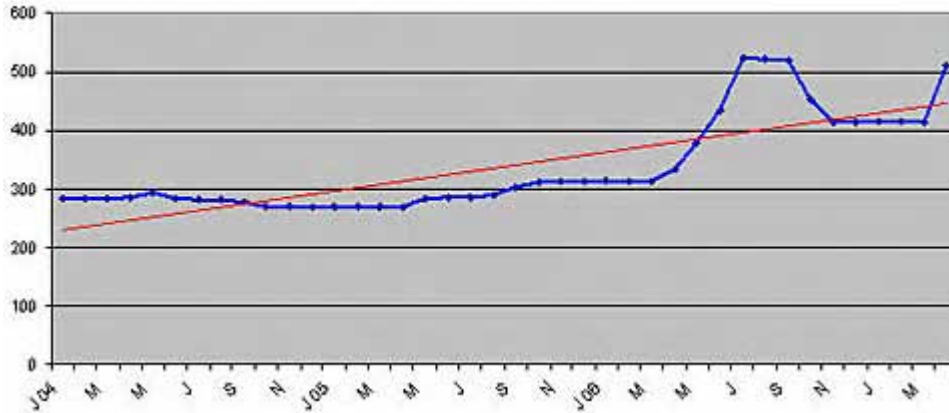
Source: TD Economics Quarterly Commodity Price Report

- Oil prices showed an increasing trend over the past five years.
- However TD Economics is forecasting a 13.1 per cent fall in average prices in 2007.
- World Bank's data indicate an 8.7% fall for January – May 2007.

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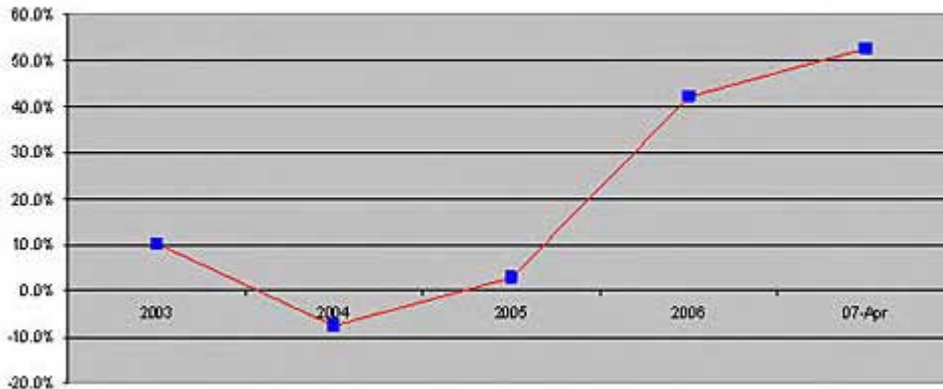
Figure 1: Graded Asphalt Cement Index - Toronto Area (2004 - 2006)



Source: MTO - Performance Graded Asphalt Cement Index

- Asphalt price retreated during the production off season – January – March 2007.
- However, in April the monthly price change was 22.6% the highest rate of change since July 2006.

Average Change in Performance Graded Asphalt Cement Index - Toronto Area



Source: MTO - Performance Graded Asphalt Cement Index

- Strong growth in Toronto's Asphalt price continued in 2007.
- Price as at April 2007 was 52.6% above prices which existed in April 2006.

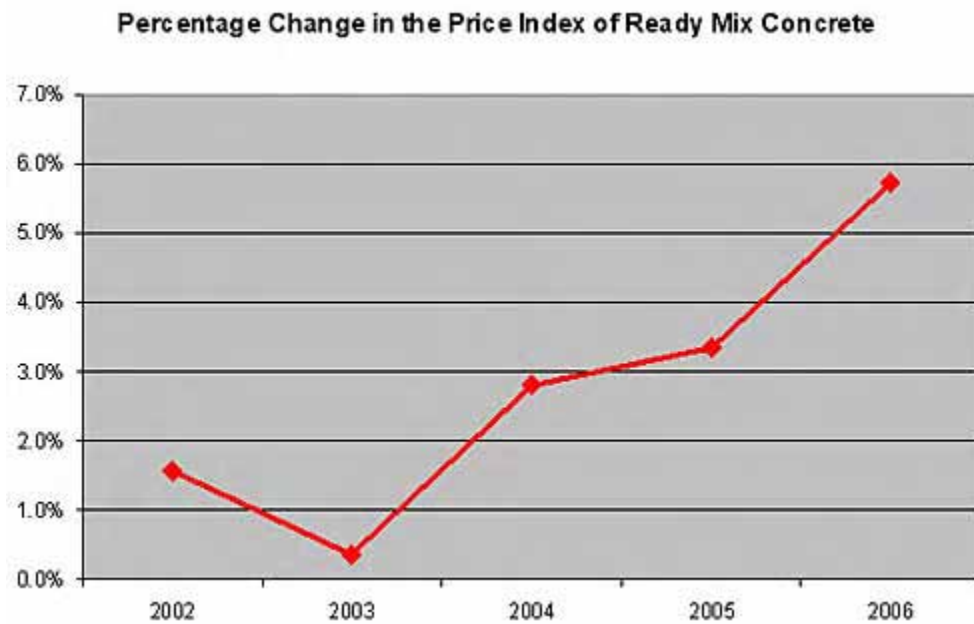
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Source: Capital Expenditure Price Statistics - STATSCAN

- There was sustained increase in the price of cement in 2006.



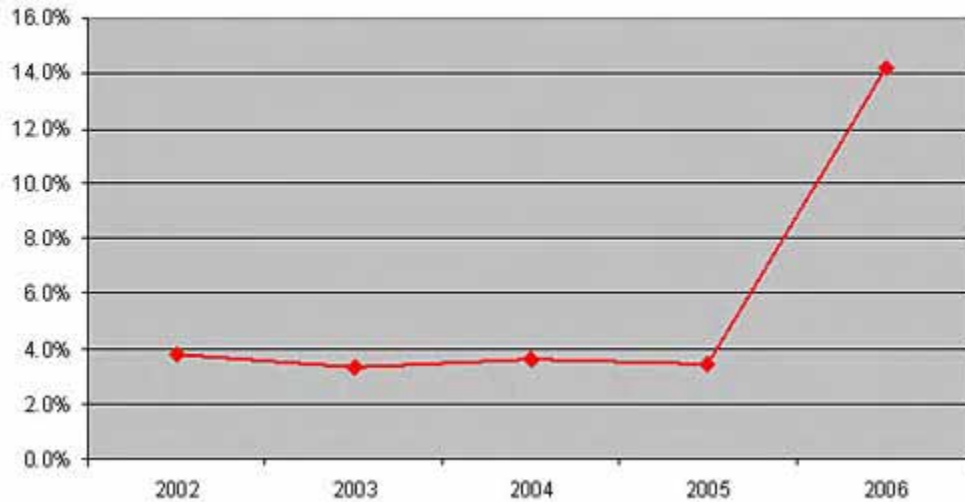
Source: Capital Expenditure Price Statistics - STATSCAN

- For the third consecutive year the price of Ready Mix concrete in Canada increased in 2006.

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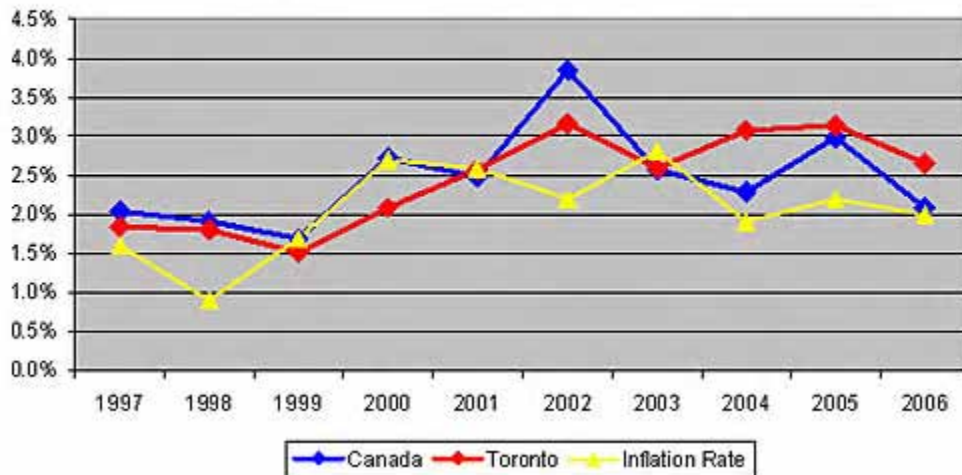
Percentage Change in the Price Index of Sand and Gravel - Canada



Source: Capital Expenditure Price Statistics – STATSCAN

- The price of sand and gravel jumped by over 13% in 2006, which was well above the annual increases observed in the previous three years.

Annual Percentage Change in the Average Wage Index (Average of 16 Construction Trades)

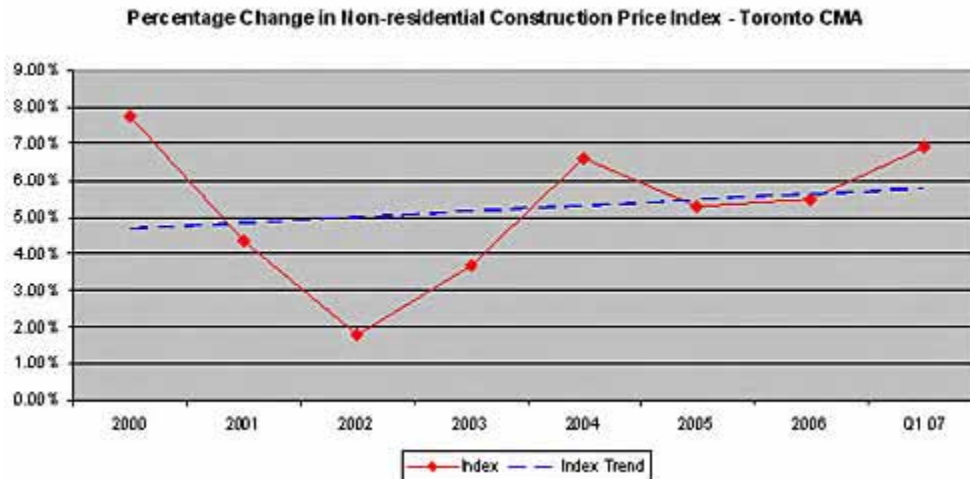


Source: Capital Expenditure Price Statistics – STATSCAN

- The wage rate of selected construction workers in the Toronto CMA exceeded both the inflation rate and the change in the national wage rate in 2005 and 2006.
- The increase in the Toronto wage rate has trended upwards since 2000.

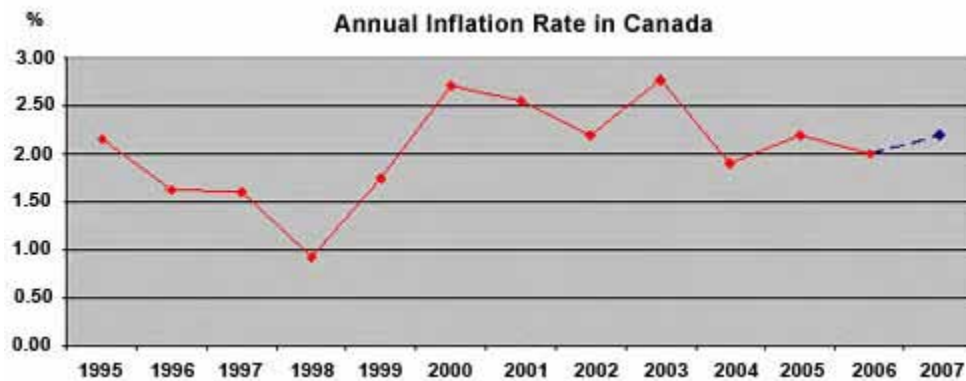
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Source: Capital Expenditure Price Statistics – STATSCAN

- The change in the non-residential construction price index continued to trend upwards.
- However, the magnitude of the increase remains lower than those recorded in some prime construction inputs.



Source: Consumer Price Index - STATSCAN

- Canada's inflation rates of 2% in 2006 and a point to point change of 2.2% in May 2007 are well below the change in the price of major construction inputs.
- Unlike inflation, the prices of major construction inputs are influenced largely by international developments.
- Canadian consumer prices have been held in check by some price-favourable domestic developments including the strengthening of the Canadian currency and competition in the retail sector.

Statement of Principles

Assessment of Tangible Capital Assets

prepared by:
Public Sector Accounting Board

Comments are requested by June 15, 2007

PSAB

Commenting on this Statement of Principles

This Statement of Principles is issued by the Public Sector Accounting Board. The members of the Board are drawn from government, public accounting, business and academe. All members serve as individuals and not as representatives of their governments, employers or organizations.

Statements of Principles propose key principles and definitions that the Board expects to include in a future Exposure Draft.

Individuals, governments and organizations are invited to send written comments to the Board on the principles and definitions set forth. Comments are requested from those who agree with this Statement of Principles as well as from those who do not.

To be considered, comments must be received by June 15, 2007, addressed to:

**Tim Beauchamp, Director
Public Sector Accounting
277 Wellington Street West
Toronto, Ontario M5V 3H2**

**For ease of handling, we prefer comments to be sent by e-mail (in Word format), to:
ed.psector@cica.ca**

Highlights

The Public Sector Accounting Board (PSAB) proposes, subject to comments received on this Statement of Principles, to expose ASSESSMENT OF TANGIBLE CAPITAL ASSETS, as a new Statement of Recommended Practices (SORP). The SORP would apply to all governments and government organizations.

The main features of this Statement of Principles are as follows:

- The assessment of tangible capital assets should include those that are recognized in the summary financial statements of an entity and those of its government business enterprises recognized on a modified equity basis of accounting.
- Information should include a physical condition rating assessment, the extent of assets in each rating category and remaining average life expectancy of tangible capital assets.
- Narrative information should provide explanations of the reasons for changes in the assessment, the implications of those changes and any known and planned expenditures that affect the assessment.

Background

Some governments have begun to report publicly amounts referred to as the infrastructure deficit. The infrastructure deficit can be defined as the difference between the forecasted financing needs related to ongoing maintenance and replacement of their tangible capital assets and the fiscal capacity of the government to generate that financing.

Government policy and intent influence a number of factors that affect the definition and measurement of a government's infrastructure deficit, for example:

- forecasting existing and growth-related needs;
- identifying an appropriate period over which to measure the requirements;
- establishing baseline service levels for government services;
- determining the condition level at which tangible capital assets must be preserved in order to meet baseline service levels;
- selecting an appropriate valuation methodology; and
- forecasting the future fiscal capacity of the government.

Due to differences in government policies, defining and measuring this “deficit” is difficult. Nevertheless, PSAB recognizes the need for additional disclosures of information about a government's tangible capital assets.

Providing supplementary information on the physical condition and remaining average life expectancy of tangible capital assets will assist users to draw conclusions about the effect a government's policies may be having on those assets and the capacity of that government to address the future funding requirements.

10. Do you agree that for each category of tangible capital assets governments should provide a further breakdown of the overall average physical condition by each rating showing:
 - (a) measurement unit and quantity;
 - (b) average age and average remaining expected life; and
 - (c) average replacement cost per unit? (Principle 10)

11. Do you agree that governments should provide a discussion of:
 - (a) the reasons for changes in physical condition over time;
 - (b) the implications of the physical condition of tangible capital assets; and
 - (c) the effects of known expenditure plans on the physical condition rating?
(Principle 11)

12. Do you agree that governments should identify the basis for condition measurement and the measurement scale used to assess and report on physical condition of assets and should provide information about changes in the basis for condition measurement and the effects of the changes? (Principle 12)

Assessment of Tangible Capital Assets

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Defined terms

Bold type is used to highlight the first time a defined term appears within the body of the text. The defined terms, together with supporting explanations, appear in Appendix A.

Purpose and scope

Principle 1

The **Statement of Recommended Practice** applies to governments and government organizations.

- .001 The principles and guidance are intended to apply to the annual reports of governments.
- .002 It is also intended to apply to government organizations who prepare their own annual reports.
- .003 The assessment of the tangible capital assets of a government is not intended to negate the need for a separate assessment of the tangible capital assets of government organizations. A separate assessment of tangible capital assets held by government organizations provides important **accountability** information by their respective managements.

Principle 2

An assessment of tangible capital assets should be provided for those assets recognized in the general purpose financial statements of the reporting entity and the general purpose financial statements of its government business enterprises.

- .004 Summary financial statements for the government reporting entity as a whole are prepared to provide an understandable overview of the full nature and extent of the financial affairs and resources which the government controls. Therefore, a government's **report** should include an assessment of the major tangible capital assets of all organizations within the reporting entity.
- .005 Governments carry out their policies and deliver services through various organizations. Some government organizations, such as departments, ministries, boards or commissions, are integral to the operations of the government and their assets are consolidated in the summary financial statements of the government. Therefore, the assessment of the government's tangible capital assets would include the tangible capital assets of these government organizations.
- .006 Some government organizations are enterprises whose principal activity is carrying on a business. These organizations are reported using the modified equity method. The tangible capital assets held by government business enterprises are not evident in the summary financial statements of the government. Nevertheless, government business enterprises such as hydro and other utilities manage significant tangible capital assets. Their assets form a part of the stock of tangible capital assets the government is responsible for and should be included in an assessment of the government's tangible capital assets. Including these assets will

provide an overview of the full nature and extent of the tangible capital assets controlled by the government.

Single government report

Principle 3

A government's financial report as described in FINANCIAL STATEMENT CONCEPTS, paragraph PS 1000.07 should include supplementary information on its tangible capital assets.

.007 Although not part of the summary financial statements, supplementary information about a government's tangible capital assets provides additional information that assists users in assessing how the government has fulfilled its stewardship obligations with respect to maintaining the resources entrusted to it.

Qualitative characteristics

Principle 4

The information provided should embody the basic qualitative characteristics of relevance, reliability, comparability and understandability.

.008 The qualitative characteristics are essential to the communication and utility of information contained in a government's report. While these characteristics are usually discussed in terms of financial statements, further guidance related to their application in other reporting formats is provided in the FINANCIAL STATEMENT DISCUSSION & ANALYSIS, SORP-1, and PUBLIC PERFORMANCE REPORTING, SORP-2.

Reference to the financial statements

Principle 5

The assessment should be clearly referenced to the related tangible capital assets reported in the summary financial statements.

.009 Given that the information about the government's tangible capital assets is based on the tangible capital assets reported in the summary financial statements, and that it supplements and complements them, reference to the related statements should be clearly made.

Presentation

Principle 6

Governments should link and reconcile their assessment of tangible capital assets to the major categories in the summary financial statements.

Link to financial statements

- .010 The supplementary information on the assessment of tangible capital assets should be linked and reconciled to the summary financial statements. The link to the summary financial statements would be established when an assessment is done for each major category of tangible capital assets reported as required under TANGIBLE CAPITAL ASSETS, paragraph PS 3150.41, in the summary financial statements. The reconciliation could be between historical cost or carrying amount of tangible capital assets upon which an assessment is completed and the amounts reported in the summary financial statements for each category and in total.
- .011 Linking the assessment of tangible capital assets to the summary financial statements has the following benefits:
- (a) It provides users with an understanding of the tangible capital assets that have been assessed in relation to the total reported in the summary financial statements.
 - (b) It provides a common definition of tangible capital assets and the major categories reported, improving comparability in reporting across governments.
 - (c) It indicates that as at a specific reporting date assets reported in the summary financial statements are known and complete.
 - (d) It ties the supplementary information on asset assessment to the reporting date to give users a snapshot view of the government's tangible capital assets.
 - (e) It assists auditors to fulfill their assurance responsibilities related to the reporting of supplementary information as tangible capital assets reported in summary financial statements have been audited.

- .012 Table 1 illustrates a reconciliation that links the supplementary information on asset assessment to the summary financial statements based on historical cost.

Table 1

Asset category	2008	Historical cost (\$ millions)	
		2008	2007
Roads network			
Assessment completed (expressways, highways, arterials and collectors, residential streets)	1,829 kms	\$6,568	\$6,366
Assessment not completed (laneways, alleys)*	<u>155 kms</u>	<u>542</u>	<u>541</u>
Total per summary financial statements	<u>1,984 kms</u>	<u>\$7,110</u>	<u>\$6,907</u>

* See table 3

Principle 7

At a minimum, the assessment of tangible capital assets should address their physical condition.

Attributes of condition

- .013 There are a number of attributes that a government may use to assess the condition of its tangible capital assets, such as:
- Physical condition — the condition of an asset that enables it to meet intended service levels.
 - Demand/capacity — the capacity of the asset to meet existing service requirements.
 - Functionality — the ability of the asset to meet program delivery requirements.
- .014 It is recognized that none of these attributes are mutually exclusive. For example, physical condition may have an impact on an asset's ability to meet service and program delivery requirements.

Physical condition

- .015 Reporting on physical asset condition is useful information that is currently missing from financial reports. It will assist users in drawing their own conclusions about the effect government policy on funding of maintenance and renewal is having on the physical condition of tangible capital assets. It is the first step to helping users of summary financial statements make conclusions about the government's management of resources and future revenue requirements to maintain, renew and replace its tangible capital assets, and the affordability and sustainability of services.

- .016 The benefits of performing physical **condition assessments** on tangible capital assets are that it:
- (a) provides information for assessing the adequacy of existing maintenance, renewal and replacement funding;
 - (b) provides information for the analysis of asset physical condition trends;
 - (c) reports on asset physical condition in a consistent format;
 - (d) assists in targeting and prioritizing asset management strategies;
 - (e) provides information for identifying and quantifying **deferred maintenance**, renewal and replacement, and emerging requirements;
 - (f) allows for assessment of the effectiveness of prevailing asset management strategies; and
 - (g) provides information for strategic asset planning processes.
- .017 The physical condition of a tangible capital asset can be compared to its ability to meet original design standards. There are engineering examples of assessments of physical asset condition: the City of Edmonton has developed an infrastructure strategy based, in part, on an assessment of the physical condition of their infrastructure assets, and the City of Hamilton publishes an annual report on the state of its infrastructure that assesses the physical condition as part of its assessment of tangible capital assets.
- .018 Subjectivity of physical condition assessment will be reduced and consistency and comparability improved when they are based on a detailed physical examination using standardized, clearly defined methodology, pre-defined defect conditions and measurement scales to determine the physical impairment of the tangible capital asset. The asset condition assessment should be reliable and verifiable. Reliable and verifiable information can be replicated by independent observers to produce similar results, and knowledgeable and independent observers would concur that it is in agreement with the underlying data with a reasonable degree of precision.
- .019 Evaluation of an asset's physical condition should be completed by qualified evaluators with knowledge of the asset, its performance capacity and the expectations for its continued performance. The assessment of the physical condition of a tangible capital asset should be completed by reference to physical characteristics and technical, engineering and other specifications of the asset. It should take into consideration:
- (a) the asset's durability;
 - (b) the quality of its design and construction;
 - (c) its use;
 - (d) the adequacy of maintenance that has been performed; and
 - (e) other factors including accidents, catastrophes, disasters and obsolescence.
- .020 It may not be possible to complete a physical examination of all tangible capital assets. For example, it is not possible to physically examine water pipes. However, physical condition could be based on a combination of age, construction materials and methods, breaks per kilometre, geological and soil conditions, etc. Whatever predictive tool is used should employ a standardized,

clearly defined methodology with pre-established logical relationships between attributes and predicted condition assessment. The results should be defensible. Governments should use industry standard best practice to predict asset conditions where they exist.

Demand/capacity

- .021 Demand/capacity issues, with the exception of paragraph .28, have been excluded from the scope of reporting on the condition of assets.
- .022 Demand/capacity is related to asset performance. For example, a bridge may be in good physical condition, but is causing traffic congestion and delays during rush hours because the current volume exceeds the bridge's original design capacity.
- .023 Measuring this attribute would involve establishing subjective baseline service levels against which to measure actual performance. Acceptable service levels can be influenced by government policy making it difficult to establish consistency in performance measures. As a result, it would affect the comparability of information and consistency in reporting about asset condition.
- .024 The demand/capacity attribute may also bring into scope efficiency and effectiveness measures. For example, it might include information about how an existing water plant is working compared to a new water plant using "the latest and greatest" technology.

Functionality

- .025 Functionality issues, with the exception of paragraph .28, are excluded from the scope of reporting on the condition of assets.
- .026 Functionality is closely aligned with quality of life measures. It is related to such things as whether or not the community centre is meeting user expectations or waiting times in hospital emergency rooms are acceptable.
- .027 Assessing these attributes would be based on subjective acceptable service levels. Some expectations of service could be "gold plated" and unsustainable because governments would need to manage the expectations of the public. Again, it would be difficult to establish consistency in quality of life performance measures. As a result, it would affect the comparability of information and consistency in reporting about asset condition.

Assessment of condition of computer hardware and software

- .028 Section PS 3150 defines tangible capital assets to specifically include computer software and hardware. Providing an assessment of physical condition of computer hardware and software is not possible since software systems critical to the operation of computer hardware lack physical substance. The condition assessment of computer hardware and software needs to take into account the ability of the systems to meet business requirements.
- .029 In order to fulfill the information technology requirements of the government's business areas, it is imperative that a reliable and secure technology infrastructure is maintained. The assessment of the condition of computer hardware and software will depend on factors like:
- (a) ongoing maintenance costs;
 - (b) processing speed;
 - (c) reliability of the networks;
 - (d) network and information security;
 - (e) risk of technological failure;
 - (f) disaster recovery capability;
 - (g) ongoing hardware and software support availability; and
 - (h) productivity and reliability of applications.
- .030 Assessment of computer hardware and software must take into consideration demand/capacity and functionality attributes. Some of the factors to consider in providing an assessment of computer hardware and software include:
- (a) functionality of existing software systems in meeting the business objectives and needs of the government (for example, business processes may result in substantial cost, operational inefficiencies or lost revenue generation opportunities);
 - (b) maintenance, protection or security of existing information infrastructure and applications (for example, the availability of training and support for older versions of software and availability of maintenance contracts for hardware) supporting critical functions of the government (for example, protecting direct life, safety or health of citizens, facilitating economic development and environmental protection);
 - (c) hardware reliability as well as performance attributes like processing speed and capacity to handle new software and upgrades, the number of users, the volume of transactions, storage requirements, etc.; and
 - (d) ability to protect the investment in legacy¹ systems that are supporting critical business processes.

¹ A legacy system has certain characteristics which may include: (a) utilization of previous generations of hardware and software; (b) utilization of older technology, architecture or application construction techniques; and (c) nearing the end of their useful or expected life and hardware or software operating systems are no longer supported or enhanced by the vendor. Generally, anything other than minor changes or enhancements are cumbersome and difficult to complete successfully; finding qualified staff to work on systems becomes difficult and expensive; frequent changes often jeopardize reliability and stability; and end users are not able to access data without intervention or assistance from information technology technical staff.

- .031 The threat posed by the existence of legacy systems that support critical business processes like payroll, airport traffic control, healthcare records management, etc. should be considered in the asset condition assessment. The existence of older versions of corporate core systems that are in danger of not being supported by software vendors or that run on hardware platforms that cannot be supported by vendors can affect the condition assessment of software and hardware.
- .032 At the same time, limitations need to be placed on the attributes reported. For example, if an information technology strategy includes the objective to conduct all business electronically or to establish a call centre to improve citizen services, the ability or lack thereof to achieve this type of future-oriented functionality would not be included in the assessment of computer hardware or software, just like the ability of a road to handle new volumes of traffic created by growth would not be considered in assessing the physical condition of the road network.

Principle 8

At a minimum, an assessment of the physical condition should be provided for those categories of tangible capital assets that are critical to the provision of a government's programs and services.

Minimum reporting requirements

- .033 A government may choose not to provide an assessment of the physical condition for all categories of tangible capital assets or all assets within a category. It may be neither practical nor economically feasible to provide an assessment of all tangible capital assets. The benefits expected to arise from providing an assessment of tangible capital assets should exceed the cost of doing so. The benefits and costs may accrue to different parties and the evaluation of the nature and amount of benefits and costs is substantially a judgmental process.
- .034 At a minimum, an assessment should be provided for those categories of tangible capital assets that are judged to be critical to the provision of the government's programs and services. Governments should establish criteria to select which assets to include in their assessments. The criteria could include consideration of factors such as the effect the tangible capital assets have on:
- (a) health and safety;
 - (b) quality of services;
 - (c) economic growth; and
 - (d) the environment.
- .035 A government may also consider the risk associated with the asset. For example, the risk associated with an acute care hospital may be greater than risk associated with a residential care facility.
- .036 To illustrate, a government may decide to provide an assessment of the physical condition of its fire vehicles but not the fire halls. The firefighting vehicles are critical to the quality of the fire and rescue services of the fire department. Failure

- of the fire vehicles could affect the health and safety of the community. On the other hand, the physical condition of existing fire halls may not be as critical.
- .037 Similarly, the water system assets are critical to the provision of clean, safe potable water and would warrant an assessment of physical condition. On the other hand, providing an assessment of the physical condition of the fleet of vehicles may not be warranted even though the fleet supports the effective operation and maintenance of the water system. The fleet assets are relatively short lived and readily replaced. No one individual or group of assets is significant to the total. No one individual unit is critical to the overall operation of the government. There is sufficient redundancy in the equipment pool to cover any failures and there may be a well-established financial plan to replace individual units at the end of their useful life.
- .038 Reference could also be made to the relative value of the tangible capital assets, the costs of ongoing sustainment and the risk to the government's financial position if the asset is not maintained or fails. It may not be necessary to report on tangible capital assets that have a low dollar value in terms of ongoing investment and low risk if they fail (i.e., a managed process exists to quickly identify and repair or replace assets that have failed or are about to fail). For example, a government may wish to provide an assessment of its major highways and expressways but not its rural roads.

Principle 9

Governments should provide the following information for each category of tangible capital assets:

- (a) historical cost;
- (b) average overall physical condition rating;
- (c) average age;
- (d) average expected life;
- (e) measurement unit and quantity; and
- (f) planned and approved expenditures.

Illustrative example

.039 The following table illustrates the presentation of a report on the assessment of physical condition of tangible capital assets that incorporates the principle. In this illustration, the government has adopted a consistent measurement scale consisting of alpha grades A, B, C, D and F where A is excellent or new condition and F is failure.

Table 2

Category	Historical cost (\$ millions)	Average condition		Average age (years)	Average expected life (years)	Measurement			Planned and approved expenditures (\$ millions)
		2008	2007			2008	2007	Unit	
Roads	6,568	C	C	25	45	1,829	1,817	kms	\$ 87
Sewers	9,345	B	B	35	75	3,795	3,777	kms	135
Water	7,465	C	D	55	75	3,845	3,817	kms	100
Transit	1,118	C	B	5	15	1,225	1,215	vehicles	18
Parks	1,182	C	C	25	65	1,081	1,081	hectares	5
Buildings	981	C	C	30	45	150	150	facilities	1
Recreation	798	B	B	20	20	320	319	facilities	5
Equipment	550	C	C	5	15	1,421	1,415	units	1
Waste	185	B	B	10	40	200	195	units	
Electric distribution	9,236	C	C	20	30	151	150	circuit kms (‘000)	125
Unrated*	2,790	n/a	n/a	n/a	n/a				
Total	\$40,218								\$477
Less GBE** (see note X)	10,236								125
Total per summary financial statement	\$29,982								\$352

* Represents tangible capital assets on which an assessment has not been completed as at the reporting date.

** Government business enterprise.

Historical cost

.040 Historical cost (or carrying amount) of tangible capital assets is used to provide the link to the tangible capital assets reported in the summary financial statements for each category (see Principle 6).

Average condition

.041 A measurement scale should provide an indication of the condition level of the assets. For example, condition could be measured by a **condition index** or as a percentage of the category of assets in good or poor condition. Governments

- could use a report card or other comparable approach to allow users to assess the current physical condition of the government's assets (see Appendix C).
- .042 A different measurement scale may be used for each type or category of asset. However, it should be cross-referenced to a common measurement scale used for all categories of assets. This will allow users to understand the implications of the condition of the individual category relative to the condition of all other categories.
- .043 To illustrate, a government may have adopted a condition index (CI) for rating the physical condition of its roads and bridges which assigns a score out of 100 based on assessment of multiple deficiencies and severity levels. At the same time, the government may have adopted a high-level, five-step alpha measurement scale for all tangible capital asset categories where A means excellent and F means failure.
- .044 Both the roads and bridges have a CI of 50 out of 100. The government would translate the CI's assigned to roads and bridges to the high-level measurement scale used for all categories. In this case, based on the assessment of relative risk associated with failure of roads and bridges, the score of 50 on roads would be considered "fair" while the score of 50 on bridges is considered to be "poor".

Asset category	Condition index	Condition assessment
Roads	50/100	C
Bridges	50/100	D

Average age and average expected life

- .045 All tangible capital assets have a finite life. Even infrastructure assets, where the intention is to maintain them in perpetuity, have a finite life due to such influences as geological conditions, technology, environmental standards, changed service levels, etc. Governments should provide the average age and the average expected life in years of tangible capital assets in each major category at the reporting date.
- .046 Tangible capital assets will require reinvestment if the government is to continue to provide services. Information about the average age compared to the average expected life or the average remaining life of tangible capital assets allows users to assess when governments may be faced with significant rehabilitation and replacement expenditures.
- .047 For example, if the average expected life of the road network is 30 years and the average age at the reporting date is 35 years, users may conclude that the government is facing significant near-term expenditures on the road network. Knowing the historical cost or replacement value, users may also get an appreciation of the amount.

Unit measure and quantity

- .048 Providing a unit of measurement and quantity can be used for statistical analysis. It can be used to link different pieces of information. For example, when coupled with physical condition assessment information, it would allow a breakdown of the total units by each condition rating. It allows users to relate the total units to the cost and calculate the average cost per unit. It allows users to make some conclusion about the future revenue requirements to maintain and replace the tangible capital assets based on the number of units and average cost.
- .049 The unit of measurement should be at the summary level. While it is recognized that there can be different units of measurement for the various components of categories of tangible capital assets, the unit chosen would be the most representative and homogenous for that category of tangible capital asset. For example, it could be kilometres of pipes in water and waste water systems even though there are other components making up that system. The other components are generally related to the size of the system as indicated by the number of kilometres of pipes.

Planned and approved expenditures

- .050 A government should provide known and approved expenditure plans related to tangible capital assets. These plans may exist in approved capital budgets. Information about future known and approved expenditures related to tangible capital assets and the affect these plans will have on the assessment of tangible capital assets is useful to users in understanding the future revenue requirements of the government.

Principle 10

For each category of tangible capital assets, governments should provide a further breakdown of the overall average physical condition by each rating showing:

- (a) measurement unit and quantity;
- (b) average age and average remaining expected life; and
- (c) average replacement cost per measurement unit.

Breakdown by condition ratings

- .051 The assessment of physical condition based on an average scoring does not give a total picture of physical condition of all assets in the category. For example, an overall average assessment score of C may not look bad, but the government could be spending on new assets rather than on maintenance, renewal and replacement of existing assets. The existence of a recently acquired new asset in the category could be skewing the average score for that asset category. There could be significant assets that are in poor or failure condition in that category.

- This is why it is important to provide a distribution of assets by each rating in the measurement scale.
- .052 In addition to providing an overall score for physical condition, governments should provide a breakdown of assets in each rating on the measurement scale. The government should provide the breakdown of the assets in each measurement scale rating by unit of measure, quantity, average age and average remaining expected life.
- .053 For example, if a measurement scale consists of alpha grades A, B, C, D and F, where A is excellent or new condition and F is failure, the government may report that the overall road network is at a C condition rating. The government should report how many kilometres out of the total are rated in each of A, B, C, D or F ratings. The following table illustrates the breakdown of the overall category by each rating on the measurement scale.

Table 3

Condition rating	Measurement*		Percentage		Average age (yrs)	Average remaining life (yrs)
	(kilometers)		(optional)			
	2008	2007	2008	2007		
A	274	262	14%	13%	5 yrs	40 yrs
B	366	374	18%	19%	12 yrs	33 yrs
C	640	659	32%	34%	23 yrs	22 yrs
D	458	436	23%	22%	32 yrs	13 yrs
F	91	86	5%	4%	45 yrs	0 yrs
Total rated	1,829	1,817	92%	92%	20 yrs	25 yrs
Unrated	155	155	8%	8%		
Total	1,984	1,972	100%	100%		

* average replacement cost per lane km \$6,125,000 (2007 — \$5,975,000).

- .054 Governments may provide the average replacement cost per unit of tangible capital assets. Average replacement cost per unit represents the amount in today's dollars necessary to acquire, develop or construct a unit of the assets similar to those owned by the government. The average replacement cost can help users understand the future revenue requirements of the government to replace assets.
- .055 Governments should provide information on the implications of the distribution of assets. For example, a government could report that 20% of its road system is in the D and F rating. However, the majority of the roads in this rating are laneways in alleys or residential streets that are of lower priority than major highways and expressways. Alternatively, the government may have made a decision not to replace the assets in lowest categories for economic reasons. For example, the government may not maintain or replace a school because it is no longer needed in the geographic area due to declining enrollments.

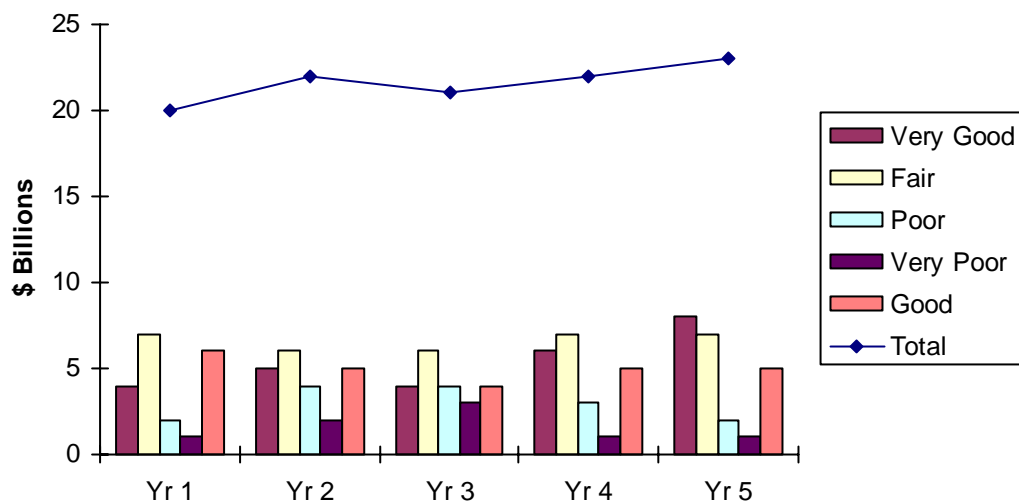
Principle 11

Governments should provide a discussion of:

- (a) the reasons for changes in physical condition over time;
- (b) the implications of the physical condition of tangible capital assets; and
- (c) the effects of known expenditure plans on the physical condition rating.

Changes in physical condition over time

- .056 Asset physical condition assessments should be completed on a regular basis such that changes in overall asset conditions can be compared over time. This information will be useful to users in assessing the degree to which assets are being maintained. Including trend information allows users to assess the effectiveness of asset management strategies and policies.
- .057 When providing comparative information, it is necessary to provide the data in a consistent manner. Governments should explain the effect of changes made to the methodologies, measurement and reporting of physical condition assessments.
- .058 The following chart illustrates a graphic presentation of the overall changes in the physical condition of a government's tangible capital assets.

**Implications of physical condition**

- .059 Many of the major tangible capital assets of a government are held in perpetuity. For example, once infrastructure assets are built, services must be continued. This means that governments must not only maintain and renew assets; they must also make expenditures on replacements when they reach the end of their useful life.
- .060 The report should include a discussion of the potential future implications of the physical condition of tangible capital assets on the government. Users need to

- have an understanding of the key factors that influence the physical condition of assets over time. This information helps users interpret the meaning and significance of the asset physical condition assessment and provides the context to understand the effects the physical condition will have on the government.
- .061 The users of the report need to understand a government's exposure to risk related to the physical condition of tangible capital assets in order to make informed judgments about the implications of such risks on the government's **financial condition** and the potential implications on future operations.
- .062 There are three primary aspects of risk that would be addressed:
- (a) identification of the risk;
 - (b) assessing the potential impact of the risk; and
 - (c) discussing the strategies and techniques adopted for managing the risk.
- .063 In the explanations and analysis, the government should focus its descriptions of risks on those likely to occur and that may have significant financial implications.
- .064 In addition to identification and description of the risks, a discussion of the government's risk management policies and strategies with regard to tangible capital assets would be provided. The report may also elaborate on other uncertainties, such as the impact new environmental standards, growth and development plans, demands for new and enhanced services, etc., may have on the government.
- .065 A government could provide a discussion and analysis of:
- (a) infrastructure improvements required;
 - (b) historical versus planned investment levels and implications;
 - (c) future implications of tangible capital assets condition;
 - (d) projected effect on condition of physical assets of historical expenditures versus planned expenditures;
 - (e) discussion of risk mitigation strategies; and
 - (f) socio-economic impacts of the condition of tangible capital assets.

Effects of known expenditure plans

- .066 A government should provide known and approved expenditure plans related to tangible capital assets. These plans may exist in approved capital budgets. Information about future known and approved expenditures related to tangible capital assets and the effect these plans will have on the assessment of tangible capital assets is useful to users in understanding the future revenue requirements of the government.
- .067 In order for users to be able to assess the effects of known and approved expenditure plans on tangible capital asset assessments, governments should differentiate between those expenditures that are planned to address deferred maintenance, renewal and replacement requirements for existing tangible capital assets from those that represent new tangible capital asset requirements (such as expenditures to accommodate growth). There may be instances where it is not

- possible to differentiate. For example, a new asset may address both the needs of growth and replacement or renewal of existing assets. In these cases, it will be important that the effects on existing assessments of physical condition of tangible capital asset be provided.
- .068 Governments should provide information on major assets that may be at or approaching the end of their useful life and that will not be replaced. For example, it may be the government's policy to shut down all coal-powered generating plants. The impact on the future expenditure plans would be provided.
- .069 The organizational objectives of a government contained in budgets tend to be very broad and are continuously redefined and may be completely revamped whenever there is a change of government. Information should be provided as to the level of assurance that planned expenditures related to tangible capital assets will actually be made and the timing of those expenditures.

Disclosing the basis for reporting

Principle 12

Governments should identify the basis for condition measurement and the measurement scale used to assess and report on physical condition of assets. Governments should provide information about changes in the basis for condition measurement and the effects of the changes.

- .070 There are numerous methodologies to assess asset physical condition in use today by engineers and other asset managers for most long-lived tangible capital assets that are of great value in managing tangible capital assets. Generally, they have developed to the point that consistent methods and measurement scales can be used to assess condition on a reliable and consistent basis. The objective is selecting a method of measuring asset physical condition that will indicate whether tangible capital assets of a government are being preserved so that they continue to provide acceptable services and achieve expected life.
- .071 Condition assessments should be based on generally accepted methods and standards where available and consistently applied. Methods of measurement should be an easy-to-understand reference that can be updated regularly to track the results of the government's asset management strategies. It should also allow users to predict the status of assets into the future based on the current asset management policies.
- .072 Characteristics of a good condition assessment methodology may include:
- (a) use of standardized indicators to identify deficiencies;
 - (b) recording of deficiencies in terms of severity and frequency;
 - (c) prompts for the inventory and inspection process ensuring that all pertinent data is collected, guiding the inspector through each step of the process;

- (d) predefined measurement scale for each type or category of asset (for example, calculating a numerical condition index on a scale of zero to 100, worst to best);
 - (e) utilization of knowledgeable inspectors with well-documented inspection procedures; and
 - (f) predetermined inspection schedule for tangible capital assets (components, subsystems or networks).
- .073 Different condition assessment methodologies may be used for major categories. The asset condition assessment methodology does not have to be consistently applied across all categories of assets. For example, both the condition assessment methodology and frequency of assessments could be different for road networks versus parks.
- .074 Computer programs exist that can assist in asset condition assessments. For example, pavement management systems exist that can rate the condition of roads based on severity levels and multiple distresses like cracking, distortions, patching and utility cuts, rutting and potholes. Computerized maintenance management systems provide information to manage work orders, store inventory and preventative maintenance schedules. **Condition assessment survey** systems help identify the existing condition of various components of tangible capital assets and produce benchmarks for comparisons and projecting such things as repair and replacement costs. Geographic information systems provide data related to physical location which can be augmented by satellite imagery. Facility condition assessment systems help organizations plan and prioritize the renewal of physical assets using lifecycle planning principles.
- .075 Governments should provide information about the condition assessment methodologies used and the measurement scales. The information may include a description of the methodologies used in the assessment of the physical condition of tangible capital assets, the general acceptance of assessment methodologies used, the qualifications of evaluators and the description of asset management systems that may be used by the government.
- .076 Once methodologies and measurement scales have been determined, it is desirable but not required that methods and standards be applied consistently from period to period. Consistency in application is important when comparing assessments of tangible capital assets between periods or at different points in time. Consistency helps prevent misconceptions that might result from the application of different methodologies and measurement scales in different periods.
- .077 When a change of methodology or measurement scale is deemed to be appropriate, disclosure of the effects of the change is necessary to maintain comparability. Any changes would be described, including the reasons for the change and the implications of such a change. Where possible, prior period assessments would be restated for consistent comparison or differences between current and previously reported assessments must be clearly articulated.

- .078 Assessment of the physical condition of tangible capital assets relies heavily on management's judgment as to the acceptable level of service. It involves a determination of the condition level at which tangible capital assets must be preserved in order to meet the acceptable level of service. At the present, there are no standards that would provide a basis for assessing the condition level at which assets begin to lose future economic benefit or service potential and consequently it would be difficult to ascertain whether the pre-established level selected by the government is appropriately representative. Therefore, it is important that a government provides information as to who has prepared and who is responsible for the assessment of tangible capital assets.
- .079 The assessment of the physical condition of tangible capital assets would require a government to obtain expert assistance from internal or external sources. The physical condition will be measured using the expert's best estimates based on assumptions that reflect the most probable asset physical condition. When a material change in an assessment of tangible capital assets is reasonably possible in the near term, the government would provide information about the nature and extent of uncertainty. Disclosure of the nature of the measurement uncertainty would include a description of the circumstances giving rise to the uncertainty and relevant information about its anticipated resolution. Assessments of tangible capital assets would include any additional evidence provided by subsequent events occurring after the reporting date.
- .080 Other relevant information a government should provide includes:
- (a) a description of the key assumptions used in preparing the assessment of physical condition and whether the assumptions are susceptible to change;
 - (b) an explanation of the changes made to past assumptions used in previous assessments of the physical condition;
 - (c) information about the effect of a change in the underlying assumptions used to prepare the assessment of physical condition; and
 - (d) the sensitivity of the assessment of physical condition to changes in the assumptions used and the reason for the sensitivity.
- .081 The government should provide information as to what has been done to ensure the reliability of the assessment of the physical condition of tangible capital assets. Information about reliability may be integrated throughout the report. Reliability may be demonstrated by including descriptions of asset management systems, the general acceptance of assessment methodologies used and the qualifications of evaluators. The government should also provide a discussion of limitations of assessments and any gaps in the information used for assessing assets.

Other additional information

Replacement cost

- .082 Governments may choose to provide information on the current replacement cost of tangible capital assets by category. Current replacement cost represents the

amount in today's dollars necessary to acquire, develop or construct assets similar to those owned by the government.

- .083 Information on tangible capital asset replacement costs gives users a benchmark against which to assess the total replacement cost of all assets relative to the amount being invested in maintenance, renewals and replacements. It also gives users an estimate of the total replacement cost of assets in relation to historical cost. Governments should acknowledge that the replacement costs do not represent a need to replace all assets in any one particular year.
- .084 The provision of a replacement value on all assets has limitations in meeting the information needs of users. Because of the longevity of infrastructure assets, it is difficult to make accurate projections of replacement values. For example, new infrastructure assets can last up to 75 years or more.
- .085 Replacement values are a snapshot at a particular point in time of the total current value of tangible capital assets. The provision of replacement values does not provide users with any indication of the timing of renewal and replacement expenditures or the effect it will have on future revenue requirements. It is, however, good practice for governments to determine replacement cost for internal management and planning purposes.
- .086 Summary information could be presented for each major category in tabular form. The following table illustrates a disclosure format which includes replacement cost.

Category system	Original cost (\$ millions)	Average condition	Expected life	Average age	Replacement value (\$ millions)
Roads	\$3,600	Good	35 yrs	25 yrs	\$6,400
Sewers	\$3,200	Fair	75 yrs	35 yrs	\$8,400
Water	\$2,400	Poor	75 yrs	30 yrs	\$7,900

Asset management plans

- .087 Governments may choose to provide details of any asset management plans² that exist. Information about these plans may include:
- the directions to be taken, given factors such as needs assessments and growth expectations;
 - tactical plans, given the existing deployment of resources;
 - long-term financing needs, including determining whether additional resources are needed;
 - operational planning, which would include **life-cycle costing** together with estimates of useful life, required maintenance and timing of major repair and replacements;

² Accounting for Infrastructure in the Public Sector, CICA, p 73.

- (e) condition assessments for identifying performance, funding requirements; and
- (f) any business risk associated with deteriorating tangible capital asset condition.

Infrastructure deficit

- .088 Governments may choose to provide financial information about the **infrastructure deficit/debt/gap**. The information should include:
- (a) a definition of infrastructure assets;
 - (b) details of the types of expenditures included in the calculation of the infrastructure deficit such as:
 - (i) deferred maintenance and renewal to bring existing tangible capital assets back to desired condition;
 - (ii) replacement of existing assets;
 - (iii) enhancing functionality of existing assets;
 - (iv) increasing capacity of existing assets;
 - (v) meeting new environmental standards; and
 - (vi) new assets to meet growth service requirements;
 - (c) details related to the calculation of **fiscal capacity** of the government to finance these expenditures such as:
 - (i) policies for establishing taxation rates, fees, and service charges; and
 - (ii) policies that affect debt levels;
 - (d) minimum or expected service levels;
 - (e) minimum or expected asset condition levels required to meet service levels;
 - (f) period over which the infrastructure deficit is calculated; and
 - (g) measurement methodology.

Providing desired or expected asset condition levels

- .089 Determining what constitutes acceptable asset condition may vary both across governments as well as for different types of tangible capital assets held within the government. It may not be either possible or desirable to maintain assets in perfect condition. It may therefore be useful for users to understand management's targets for physical condition of tangible capital assets by major category.
- .090 The government may establish the minimum or target condition level for each asset category against which actual condition assessment measures can be compared. This will give users access to information that will allow them to determine whether assets are being preserved at the target condition level established by the government.
- .091 Governments may provide the minimum or expected condition level for each asset category. For example, the asset category has been rated as C while the desired rating is B. Similarly, even though the overall rating for the category is B, 10% of the assets in a category are in the D and F rating. It is the goal of the government to have only 5% in this rating.

Frequency of reporting

- .092 The assessment of the physical condition and life expectancy of tangible capital assets should be included in the government's report. Assessments would be done as close to the related reporting date as is practical.
- .093 Most governments may not perform detailed assessments of physical condition annually on all categories of tangible capital assets because of the magnitude of the information gathering and processing required. A government may choose to complete a detailed assessment on major categories of tangible capital assets on a cyclical or rotational basis. It may decide to do annual assessments on critical assets and cyclical assessments on other assets. For example, it may decide that it is warranted to do an annual assessment of bridges, while assessing parks every five years.
- .094 Tangible capital assets are "living" assets. They change over time due to various factors and therefore assessments presented in the report should be updated on an ongoing basis to provide information about effects of these factors between assessments. It is important to provide new information, not just reproduce previously completed assessments.
- .095 In the years between actual assessments of physical condition, an extrapolation of the previous assessments of physical condition could be used to provide an assessment as at the current reporting date. Each year, the government would consider the effects of factors such as age, maintenance and renewal policies, expenditures, utilization, etc., on the physical condition of tangible capital assets and determine adjustments required to update previous assessments.
- .096 For example, a government may employ asset management systems that can extrapolate the current physical condition of assets at the reporting date by taking into account factors like previously completed assessments, expenditures since the previously completed assessment, maintenance records, utilization and age.
- .097 A government should provide information about which assets have been assessed in the reporting period, the rationale for and frequency of the assessments of physical condition.
- .098 Where an actual assessment of physical condition has not been completed in the period, a discussion of the basis upon which previous assessments have been updated and the changes in the previous assessments resulting from new information should be included. For example, the discussion may provide information on the impact that expenditures have had on the overall asset physical condition assessment.
- .099 Where an actual assessment of physical condition has not been completed and it is impractical to update previous assessments, governments should provide information about the most recent assessment.

- .100 The level of assessment does not have to be consistent for all categories. For example, a government could provide detailed assessments of physical condition on categories of tangible capital assets that are critical to providing government services while completing only minimal assessments to satisfy management and reporting needs on assets that are of minor significance to attainment of the objectives and goals of the government.
- .101 Governments should provide the basis and rationale for which categories they are providing assessments. A government may not have sufficient information on all of its major categories to complete an assessment. This does not negate the need for the government to provide an assessment on all major categories of tangible capital assets judged critical to the provisions of services and programs. In a situation where the government does not have the data, it should provide information on its plans to complete an assessment on all major categories of assets.

Level of detail

- .102 The level of detail disclosed by governments in the assessment of tangible capital assets should reflect the highly aggregated nature of summary financial statements. In deciding the level of detail to disclose about the government's assessment of the physical condition of tangible capital assets, governments should consider the usefulness of the information to the reader in assessing the condition of tangible capital assets.
- .103 The initial assessment of the physical condition and life expectancy of tangible capital assets will require considerable effort. In addition, while the recommended practices are equally applicable to governments of varying sizes, the capacity of governments to apply the recommended practices will vary. Therefore, it is anticipated that the assessment of physical condition and life expectancy of all major tangible capital assets of a government will be achieved over time. Governments should provide the information for those categories of tangible capital assets for which assessments have been done. Governments should provide information about those categories for which an assessment has not been completed, whether or not an assessment is planned and the timing of reporting.

APPENDIX A

DEFINED TERMS

Accountability is a broad concept that requires the entity to answer to elected officials and the public they represent to justify the raising of public resources and to explain the purposes for which they are used. It includes providing useful information for assessing the performance of an entity.

Condition assessment is the technical assessment of the physical condition of a tangible capital asset using a systematic method designed to produce consistent, relevant and useful information. The objective of a condition assessment is to provide sufficient information on asset condition to allow informed strategic asset planning and management decisions to be made.

Condition index is a tool for representing the overall physical condition of a complex asset. Complex assets are made up of multiple components and subsystems and each has multiple modes of degradation and failure. A condition index combines all factors using a multiple-criteria assessment approach into a single indicator of the condition of the asset. The critical objectives of a condition index are:

- **Indicative** — the index must provide a meaningful indication of the suitability of the asset for continued service or be representative of the overall asset physical health.
- **Objective** — the index should, wherever possible, rely on objectively verifiable measures of asset condition as recognized in the industry as opposed to subjective observations and condition risk factors. Probability of failure is then based on engineering judgment and industry experience.
- **Simple** — the index should be understandable and readily interpreted.

Condition assessment surveys are periodic inspections of tangible capital assets to determine their current condition and may provide an estimated cost to correct deficiencies. Surveys are based on generally accepted methods and standards consistently applied. Surveys include a description of the required standard for acceptable condition against which actual condition can be benchmarked.

Deferred maintenance is required maintenance that was not performed when it was scheduled to be done and that, therefore, is delayed to a future period. It includes preventive maintenance, normal repairs, replacement parts and structural components, and other activities needed to preserve the tangible capital asset so that it continues to provide acceptable services and achieves its expected life. Maintenance excludes activities aimed at expanding capacity or an asset or otherwise upgrading it to service needs different from originally intended. (FASAB Statement No. 6, “Accounting for Property, Plant and Equipment”) Where the amount of maintenance is less than the amount required to maintain an infrastructure asset at its current level of activity, then deferred maintenance may accumulate. Deferred maintenance may be recognized in a number of ways. Although it may result in a future outflow of resources, it does not meet the definition of a liability as there is no obligation to a third party. In some jurisdictions,

deferred maintenance is recognized by acknowledging that the deferred maintenance has reduced the value of the asset and devalued the asset accordingly. Regardless of how deferred maintenance is acknowledged in the financial statements, it is highly desirable that governments have information of the collective amount of deferred maintenance, as it represents an internal claim on future resources. There is a link between the method and rate of depreciation applied to infrastructure assets and the maintenance expense. Some entities may choose to perform less maintenance and anticipate a shorter working life for an asset. (IPSASB, “Guideline for Governmental Financial Reporting Exposure Draft, 1998”).

Financial condition describes an entity’s financial health in the context of the overall economic and financial environment. There is no single indicator of financial condition of a government. Rather, it is a combination of:

- the financial position of an entity as measured in the financial statements;
- changes in the government’s financial position as measured in the financial statements;
- financial and non-financial performance measures; and
- additional supplemental information external to the financial statements that adds depth to the financial statement indicators (discussion and analysis, performance reports, etc.).

Fiscal capacity, used to estimate the infrastructure deficit, is generally based on the level of funding currently committed in government budgets to invest in tangible capital assets.

Infrastructure deficit is generally defined as the gap between future financing requirements for expenditures on tangible capital assets and the forecasted fiscal capacity of the government organization to generate the required financing through its own source revenues (for example, taxation, fees and service charges, government transfers, development charge levies, fines and penalties, etc.) and debt capacity. Infrastructure has been interchangeably referred to as **infrastructure debt** or **infrastructure gap**. Investments may include addressing deferred maintenance, renewal and replacement of existing assets as well as new assets to address growth, changed environmental standards and program enhancements.

Life-cycle costing is an acquisition or procurement technique that considers maintenance and other costs in addition to the acquisition costs of assets. It results in a forecast of maintenance expense that may serve as a basis against which to compare actual maintenance expense and estimate deferred maintenance.

Report refers to the annual summary report published by a government on its financial condition as at the financial statement date and its performance during the period.

Statements of Recommended Practice (SORP) are issued by PSAB with respect to matters of reporting in the public sector. The objective is to enhance decision making and accountability usefulness of financial reports by addressing specific aspects of reporting on financial condition and financial and non-financial performance. SORPs do not form a part of generally accepted accounting principles. They are not prescriptive, but offer general guidance to encourage and assist public sector entities in effectively reporting









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relevant information that is useful in evaluating the government's financial condition at the financial statement date and its financial and non-financial performance during the reporting period.

APPENDIX B**EXAMPLE OF CONDITION MEASUREMENT SCALE**

Condition status	General description	Requirements
Very good	Some aging or deterioration of a limited number of components	Normal inspection and maintenance
Good	Deterioration of some components	Normal inspection and maintenance
Fair	Noticeable deterioration or serious deterioration of specific components	Increase diagnostic testing, possible replacement needed before “x” years depending on criticality
Poor	Widespread serious deterioration or significant deterioration of a dominant component	Start planning process to replace, considering risk and consequences of failure
Very poor	Extensive serious deterioration or serious deterioration of a dominant component	At end of life, immediately assess risk; replace based on assessment

APPENDIX C**EXAMPLE OF REPORT CARD STYLE CONDITION RATINGS**

Asset Group	Rating 2005	Comments	Trend 2020
Water	B	Water and wastewater are moving towards sustainable funding. Therefore, the assets are being maintained at an appropriate level of service.	
Wastewater	B	However in both asset categories there are significant increases in asset replacement/rehabilitation required over the next 20 years as a result of the aging of the underground inventory	
Roads	D	A significant backlog exists in the road infrastructure and the assets continue to deteriorate. This backlog needs to be addressed to avoid a further slide in asset condition.	
Storm water	C	A long-range plan is currently being prepared for storm water management. An asset management plan needs to be completed and its costs assessed in terms of impact on the water and sewer revenues, since this function was transferred to the rate program with little (if any) additional funding.	
Waste Management	B-	Many new facilities are being built and new programs being implemented over the next few years. Other facilities are older and will require attention. The challenge will be to immediately implement sustainable management practices in all areas, including funding for future replacement.	
Facilities & Open Spaces	C	Many facilities and open spaces are at the end of their useful lives, and the funding for maintenance and replacement is not at a sustainable level. This will have a negative impact on service levels if not addressed in the short term.	
Transit	B	Currently sustainable, but subject to the vagaries of senior levels of government for funding. System expansion will be a significant challenge in the future.	
Fleet	C	Cost recoverable operation as a result of a chargeback system for fleet services. Significant replacement backlog exists, which negatively impact operating costs.	

Source: City of Hamilton, 2005 Life-Cycle State of the Infrastructure Report On Public Works Assets