

A PSD CASE STUDY

PUBLIC SECTOR DIGEST

INTELLIGENCE FOR THE PUBLIC SECTOR.



THE SUSTAINABLE FOUNDATION:

SERVICE, ASSET, AND FINANCIAL SUSTAINABILITY AT THE
DISTRICT OF NORTH VANCOUVER

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THE DISTRICT OF NORTH VANCOUVER

Maintaining the District's current financial health and providing for a long-term sustainable future are top priorities for the District. One of the ways we are working to achieve this is through our work in asset management.



With senior levels of government now starting to focus on local government asset management, it is of fundamental importance for local governments to realize that asset management is not a compliance exercise to satisfy a legislative requirement to have an asset management plan. It is about stewardship of communities, sustaining a way of life, and bringing levels of service into alignment with the price citizens are willing to pay.

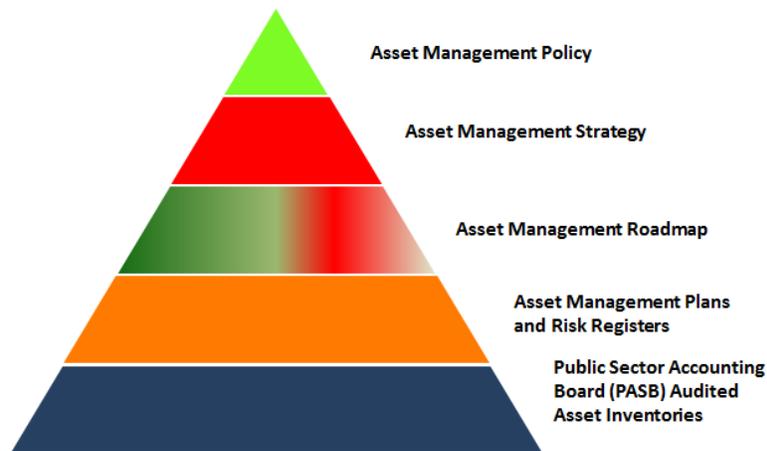
With clear council direction, staff expertise, and the use of international best practices in asset management, our interdisciplinary Asset Management Steering Committee has been working since 2006 to continuously improve and manage our existing infrastructure assets.

The cornerstone of our work is Australia's National Asset Management Strategy (NAMS) developed by the Institute of Public Works Engineering Australia, a scalable guided pathway that empowers municipalities, helps develop asset management plans, and facilitates their integration with long-term financial plans. The District was an early adopter among local governments in Canada and we are one of over 80 other municipalities in Western Canada adopting NAMS.

At the District, our asset management is grounded in what we call "The Sustainable Foundation"; a fully integrated asset management approach that brings our entire organization into alignment. Integration is achieved by:

- a) Developing asset management plans from the bottom up and setting policy at the top. Strategy brings it all together.
- b) Combining best practices in accounting, engineering, financial planning, and sustainability performance measurement.
- c) Shifting our culture away from silos to a corporate mindset focused on building organizational capacity.
- d) Training staff in finance, engineering, operations, and planning together on how to develop asset management plans and integrate these requirements into long term financial planning.





The Sustainable Foundation 1

The Sustainable Foundation has five levels we consider essential to developing robust local government asset management.

PSAB inventories lay the foundation for a consistent, repeatable inventory with additions and disposals reviewed each year by our auditors.

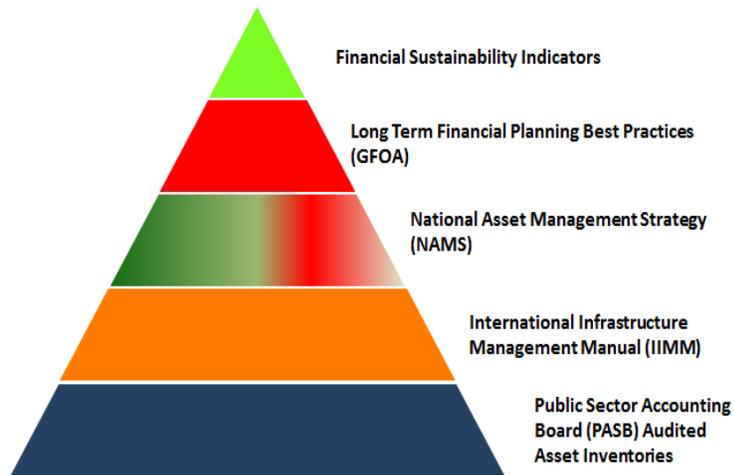
Asset Management Plans are developed for each major asset group including an assessment of three asset conditions (physical, demand/capacity, and functionality), levels of service at both the customer and technical levels, and risk assessments on each asset within the group. Asset requirements are articulated in ten and twenty year plans for operating, maintenance, and capital. These ten and twenty year requirements feed our long term financial plans and help chart the path toward financial sustainability.

The Roadmap is a guide on how to develop Asset Management Plans that are backstopped by Risk Registers and Public Sector Accounting Board Inventories. Our Roadmap and Asset Management Plans use NAMS and the Asset Management BC Roadmap. The Roadmap and Asset Management Plans are made more reader friendly by mapping all requirements into InfraGuide’s seven questions. For the District these are:

- 1) What is the asset?
- 2) What do we own and where is it?
- 3) What is it worth?
- 4) What condition is it in?
- 5) What needs to be done and when do you need to do it?
- 6) How much will it cost?
- 7) What is next?

Strategy essentially summarizes Asset Management Plans into a consolidated corporate view and quantifies infrastructure backlog, funding gaps, corporate deliverables, and expected outcomes that will move the organization forward toward sustainability.

Policy supports a long term vision of asset management that transcends council terms. Gaining council support takes time and experience shows that working from the bottom up developing asset management plans first gives council solid information and confidence that the policy is designed on a foundation of best practices. Said another way, “There are votes in sustaining existing infrastructure and your community.”



The Sustainable Foundation 2

The Sustainable Foundation also shows how we bring together best practices in accounting, engineering, financial planning, and sustainability performance measurement.

Canadian Public Sector Accounting Board's (PSAB) Conceptual Framework Task Force (CFTF) is undertaking a comprehensive review of the concepts that underlie the reporting of financial performance in the general purpose financial statements of public sector entities. In the opinion of the author, the current standards work well, but lack fair value measures (replacement values) for depreciation and tangible capital assets. Further, the concepts of intergeneration equity are being debated but require future oriented thinking about the next generations. Infrastructure deficits (backlog) have been long in their creation. For long lived assets in particular, past generations have laid a solid foundation of assets that have been paid for. Today, generations continue to enjoy the services these assets support but lack a willingness to sustain them (pay for them). The challenge for PSAB's CFTF is that financial statements traditionally report on the past and don't look to the future. PSAB has an opportunity to play a significant role in financial sustainability if they bring PSAB standards into alignment with fair value measures used by other professions charged with the renewal and replacement of existing infrastructure.

NAMS is based upon the International Infrastructure Management Manual (IIMM). We have found the NAMS templates and guided pathway to be an excellent approach to progress toward sustainable asset management. The NAMS approach is: training must be interdisciplinary (key to breaking down professional silos and siloed thinking), asset management plans are reader friendly (less than 30 pages per plan), risk registers and risk management plans support each asset management plan, asset strategy integrates those plans, and policy leads from the top. We assess progress using the NAMS Core Maturity Assessment tools that are integral to the NAMS guided pathway. Asset Management BC has been making NAMS available to BC municipalities since 2010.

Concurrent with the work of Asset Management BC, the **BC Government Finance Officers Association** has been developing a best practices approach to long term financial planning. The idea is that regardless of your approach to asset management you should be able to easily integrate your long term asset management requirements into your long term financial plans (which ultimately support the service vision of your municipality). At the District, this is exactly what we have been doing. The integration of these best practices provides a clear understanding of your infrastructure backlog (if any), future investment needs, and the financial challenges to be overcome to ensure that services, assets, and finances are sustainable.

Financial sustainability needs to be monitored, but it's not always clear how that should be done. The key is to find others that are leaders in financial sustainability and model their well thought out approach. Look to South Australia and their award winning Financial Sustainability Program (FSP). There, you will find 27 Information papers (revised in February 2012) that put Australia far ahead of Canada and others in the measurement of financial sustainability.



Financial Sustainability Indicators

At the District, we have researched and studied the FSP. One particularly relevant paper is Information Paper #9, Financial Indicators. These indicators are also recommended best practice by the Institute of Public Works Engineering Australasia. Here's how they work:

Financial Performance

- **0% to 15% Operating surplus ratio** (inclusive of Fair Value Depreciation) = sufficiently funded to sustain existing assets (the built environment).

Financial Position

- **(100%) Maximum Net financial liabilities ratio** (the significance of net amount owed compared to revenue) = okay to borrow strategically.

Asset Performance

- **90% to 110% Asset sustainability funding ratio/Asset renewal funding ratio** (the extent to which assets are being replaced over the required funding in Asset Management Plans).

Operating Surplus Ratio

Start with your Canadian PSAB audited Statement of Operations:

1. Numerator - Use only major controllable revenues (exclude land sales as they are not sustainable over the long term in the replacement of assets + 1X grants from senior governments + minor revenues like donations).
2. Denominator - Use total expenses but replace historical cost depreciation on the Statement of Operations with fair value (replacement value) depreciation.

Indicator #1	Operating Surplus Ratio				
In millions	2009	2010	2011	2012	2013
Major Controllable Revenues	\$ 136	\$ 143	\$ 151	\$ 158	\$ 166
Operating Expenses @ Fair Value	152	154	158	163	166
Surplus (Deficit) with FV depreciation	(16)	(12)	(7)	(5)	0
Operating Surplus (Deficit) Ratio	-11%	-8%	-5%	-3%	0%
Minimum Benchmark Target	0%	0%	0%	0%	0%

To see progress, you need to have strategies in place to address your infrastructure backlog via cost containment, service reduction, and revenue generation. Track progress annually. The operating surplus ratio moves you toward steady state replacement of existing assets. At the District, we have had strategies in place for a decade. In 2013, we hit the minimum best practice benchmark.

Net Financial Liabilities Ratio

Use your PSAB audited Statement of Financial Position:

1. Numerator - Use your Net Financial Assets/Liabilities per PSAB
2. Denominator - Use your major controllable revenues

Indicator #2	Net Financial Assets (Liabilities) Ratio				
In millions	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Net Financial Assets (Liabilities) \$	38	\$ 50	\$ 60	\$ 72	\$ 86
Major Controllable Revenues	136	143	151	158	166
Potential Debt Room	(174)	(193)	(211)	(230)	(252)
Net Financial Assets (Liabilities) Ratio	28%	35%	40%	46%	52%
Maximum Benchmark Target	-100%	-100%	-100%	-100%	-100%

In general terms, the amount of debt is subjective. Research on debt shows that a cap on debt is recommended and that debt referenced to major controllable revenue is a better measure than others. Holistic and strategic use of debt is best when it augments progress toward steady state replacement of existing assets. Under the FSP, total debt is capped at 100% of major controllable revenues. Local governments with positive, growing net financial assets might be viewed as being “debt adverse” if their infrastructure backlog is not actively being managed.

Asset Sustainability Ratio

Tracking progress on infrastructure backlog reduction:

1. Numerator - What you actually spend on existing assets each year
2. Denominator -
 - Option 1: Use fair value depreciation until you have your asset management plans for each asset group.
 - Option 2: Use what your asset management plans say are required to sustain existing assets.

Indicator #3	Asset Sustainability Ratio				
In millions	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Sustainment Capital Investment \$	16	\$ 15	\$ 16	\$ 17	\$ 13
Asset Management Plan Requirements	20	21	21	22	22
Annual Asset Sustainability Ratio	77%	72%	76%	77%	58%
Three Year Moving Average			75%	75%	70%
Minimum Benchmark Target		90%	90%	90%	90%

This ratio is not about funding power (that is essentially covered by the Operating Surplus Ratio). This is about monitoring if you are using that funding power to reduce your infrastructure backlog and sustain your existing assets. Expect some variability when projects are delayed or some large gains if you have some major assets being replaced. It is important to understand that you can reach sustainability in the Operating Surplus Ratio, but still have some way to go to recover the infrastructure backlog under the Asset Sustainability Ratio.

When these three FSP ratios are combined, they effectively track progress toward:

- a) Making your operations capable of sustaining your assets.
- b) Learning to use debt strategically and holistically.
- c) Renewal and replacement of existing infrastructure.



Moving Forward

Building a sustainable foundation takes time, but if you don't start you will never finish. In the context of systems thinking, "seeing a system" helps bring it to life. Once you have a vision, you need to make it a shared vision. That is what The Sustainable Foundation is really all about; having a shared vision, bringing alignment to the organization and the key stakeholders that all play a role in stewarding local government to long term sustainability.

At the District, we leverage all parts of The Sustainable Foundation seeing our work as a continuous quality improvement project that moves our municipality toward service, asset, and financial sustainability. Policy may stand the test of time, but all other parts are moving, updated annually in ways that demonstrate we are a learning organization, training staff, building corporate memory, and bringing an asset-centric mindset to all parts of our business.

"As a community we too often take our core infrastructure for granted until it breaks down. It is too easy for local governments to starve capital replenishment and bring in artificially low tax rates in order to balance budgets – the long term consequences of this can be catastrophic. Financial sustainability is critical for the guarantee of future liveability within our community."

- Richard Walton, Mayor, District of North Vancouver

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