Asset Management and GASB 34 – Challenge or Opportunity?

Fasten your seatbelts - potholes ahead! Beginning next fiscal year, as early as July in some places, state and local governments must include the value of public infrastructure such as roads and bridges in their annual financial statements. The accounting rule—a radical change that some public officials want to ignore or downplay—probably will force state and local governments to allocate more money for infrastructure preservation. It could also revolutionize how infrastructure is financed and managed.

For too long, public infrastructure has been built without regard for the costs and difficulty of operations and maintenance (O&M). This is because funding and program responsibilities have been fragmented between capital and maintenance functions. In the 1950s and ’60s, the federal government limited the use of the Highway Trust Fund to new construction. That constraint forced state and local governments to use their own revenues for maintenance, which was often deferred, resulting in the premature deterioration of our nation’s highways.

In the late 1970s, the Pennsylvania Avenue Redevelopment Corporation restored the downtown section of Pennsylvania Avenue in Washington, D.C. Once completed, Pennsylvania Avenue reverted back to the City for operations and maintenance. The restoration project included installation of crosswalks using individual brick pavers. While aesthetically pleasing, these brick pavers were very expensive to maintain due to their tendency to move and become dislodged, particular during the winter months. Eventually the City’s Public Works Department replaced the brick crosswalks with easier-to-maintain poured-in-place concrete that simulated the look of bricks.

This story demonstrates what happens when capital improvements are made without regard for the costs or difficulty of operations and maintenance. In this case, the Redevelopment Corporation funded reconstruction, but not maintenance. Since long-term upkeep was someone else’s responsibility, they focused on the aesthetics of the project without regard for the costs of maintenance.

Despite increased funds for highway rehabilitation and restoration over the past two decades, the imbalance in funding between capital and maintenance remains. In 2000, all levels of government spent almost twice as much on capital projects as on O&M. According to the Federal Highway Administration (FHWA), state transportation agencies used 60% of highway funds for capital projects, but just 18% for O&M. In contrast, local governments spent 31% of their highway funds on capital projects, and 40% on O&M.

Preserving our investment in highways means taking better care of them. Medical insurers recognize that it is cheaper to keep people well than treat them after they become sick. Likewise asset management maximizes highway service performance while minimizing life-cycle costs. Asset management encourages infrastructure managers to consider trade-offs between deferred maintenance and preservation, between short-term fixes and long-term solutions, and between today’s costs and tomorrow’s benefits.

The implementation of new governmental accounting rules may encourage this approach. In June of 1999, the Governmental Accounting Standards Board (GASB) approved new financial reporting requirements that will encourage state and local agencies to become better stewards of their infrastructure. GASB is a private, non-profit organization that defines “generally accepted accounting principles” for state and local governments. Statement No. 34: Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, requires state and local governments to include long-lived infrastructure assets in their annual financial statements as early as fiscal year 2002. GASB 34 also requires
Members of AASHTO proposed this alternative approach, based on the concepts of asset management. They argued that governments that preserved their infrastructure should not have to depreciate these assets.

By illuminating what has traditionally been considered merely a sunk cost, GASB 34 ought to radically change the way infrastructure is financed, documented, and ultimately managed. Its infrastructure-reporting requirements ought to promote fiscal accountability and asset management of public infrastructure, including highways. Since state and local governments will be held accountable for how they manage infrastructure, they will not be allowed to simply wait as in the past for federal funds to finance replacements of deteriorating infrastructure.

But we need to encourage public officials to apply GASB 34 in the most beneficial way by applying the Modified Approach to infrastructure reporting. However, public officials may hesitate to embrace this approach, favoring depreciation-based reporting as an easier way to achieve compliance with GASB 34. Facing term limits, these officials may balk because of the long timeframe needed to demonstrate the benefits of asset management.

We need to demonstrate the sizable cost savings of asset management when applied to infrastructure (illustrated by the chart above), and educate public officials regarding the many advantages of preserving infrastructure. GASB 34 establishes a major impetus for this, while also providing a basis for private sector involvement in financing infrastructure renewal. Such private-sector involvement is needed because traditional sources of highway funding cannot keep pace with the needs. With improved vehicle fuel efficiency and development of alternative power sources, the gasoline tax could soon become obsolete. GASB 34 may alert investors to potential opportunities for new highways, by providing a better assessment of what infrastructure needs replacing and by when. These reports may also encourage the public sector to take better care of existing facilities, therefore motivating investors to seize public-private partnership opportunities. On-going expenditures on preservation will avoid deferred maintenance and the high costs of premature asset replacement.

GASB 34 promises to make asset management more than a management fad. Ideally, it will influence all aspects of highway development and preservation, from planning, design and construction to maintenance, rehabilitation and disposal. But we may need to encourage public officials to implement GASB 34 in a meaningful way, accounting more carefully for the true costs of deferring repairs to the nation’s highway infrastructure and promoting preservation of these assets.

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