August 13, 2012

City Council
Committee Report

To: **Mayor Canfield & Members of Council**

From: **Lisa Oakes**

Re: **Ontario Regulation 284/09: 2012 Budget Matters - Expenses**

Purpose:
This report is being presented to Council in order to meet the requirements of Regulation 284/09 under the Municipal Act, 2001. This report contains information related to changes in financial reporting and budget requirements for municipalities as a result of the new Public Sector Accounting Board (PSAB) accounting standards. Municipalities must prepare a report which meets the requirements of the Regulation and the report must be adopted by resolution.

Recommendation:
That Council adopt this report by Resolution as required under the Municipal Act, 2001, Ontario Regulation 284/09.

Background:
On June 5, 2009, the Province approved legislation which changed the financial reporting and budget requirements of municipalities. As a result of the new requirements, municipalities were to prepare annual Financial Statements in accordance with generally accepted accounting principles for local governments as recommended by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). These accounting principles included accounting for employment liabilities, landfill costs and tangible capital assets.

The Municipal Act requires that municipalities prepare balanced budgets which include estimates of all sums required during the year for the purposes of the municipality.

The new PSAB accounting standards adopted for municipalities do not require that budgets be prepared on the same basis. With the implementation of these new accounting rules, municipalities must record amortization on tangible capital assets. This becomes an annual expense of the municipality. It was realized that the requirement to include amortization expenses in municipal budgets could have significant impact on a municipality's tax levy. For many municipalities there would be the potential for a significant variance between the amount raised through the budget process to fund capital asset renewals and the annual amortization expense as reflected in the financial statements.

In recognition of this concern, the Municipal Act, 2001 was amended and Ontario Regulation 284/09 Budget Matters – Expenses was passed to address these changes. The Regulation permits municipalities to exclude a portion or all of the following expenses from their annual budgets:

- Post employment benefits expenses,
- Solid Waste landfill closure and post-closure expenses, and
- Amortization expenses (related to tangible capital assets).

However, the legislation requires staff to prepare an annual report to Council which:

- Identifies the expenses that have been included in the Financial Report but excluded from the budget,
- Identifies the impact of these differences on the change in the City's accumulated surplus, and
- Analyses the impact of excluding these expenses from the budget on future capital assets funding requirements.

For 2011 and subsequent years, Regulation 284/09 requires that before Council adopts the annual budget, it must first receive a report as outlined above and adopt that report by Resolution.

The Ministry of Municipal Affairs and Housing will initiate a review of this Regulation on or before December 31, 2012.

Financial Implications:
As permitted under Regulation 284/09 in preparing the budget for a year, a municipality may exclude from the estimated expenses all or a portion of the following:

- Post employment benefits expenses,
- Solid waste landfill closure and post-closure expenses, and
- Amortization expenses (related to tangible capital assets).

The City, like most municipalities, continues to prepare budgets on the traditional funding basis where revenue and expenditures for operating and capital budgets are balanced.

Post employment benefits expense:
PSAB standards do not require liabilities associated with employee future benefits to be fully funded by setting aside any portion of the accumulated surplus as reserve and/or reserve funds. Employee future benefits include sick leave benefit plans, long-term disability plans, workplace safety and insurance act benefits (WSIB), vacation agreements and post-retirement plans. Benefits are earned by employees in the current period but not paid for by taxes or rates until future period and potential future WSIB payments.

Amortization expenses:
Annual financial statements now include amortization expense on tangible capital assets as required by the new PSAB standards. The amortization is based on the cost of the assets when they were built or purchased. Because amortization is based on the City's original cost to acquire an asset, it does not represent the amount that is required annually to provide sustainable capital asset funding. The annual need for funding would typically be significantly greater than the amortization expense because the amortization is not necessarily the cost to repair or replace the asset in today's dollars and using current standards, as well as the assets may need to be replaced before the end of their amortization period. If replacement and historical cost were equal, and if there was no existing infrastructure deficit (ei. No backlog of capital requirements), amortization expense could represent a reasonable estimate of the annual funding required for sustainable tangible capital asset funding. Therefore, excluding amortization expense from the City's budget does not have a direct impact on determining future tangible capital asset funding requirements. The replacement value for existing assets and the backlog of needs would more realistically determine future tangible capital asset funding requirements.

Regulation 284/09 requires a municipality to identify the impact of the 2012 budget on the City's accumulated surplus after converting the 2012 budget and assumptions to the full accrual basis of accounting.

The Post employment benefits & amortization expenses that were not included in the City's budget for 2012 is outlined below. The result of changes to accounting standards is that the City's surplus for budgeting purposes differs from the surplus on the City's financial statements. The estimated effect on the 2012 ending surplus due to the excluded expenses and change in reporting is anticipated to be a net increase of $1,140,228, summarized as follows:

Post employment benefits expenses	*($ 19,690)
Acquisition of tangible capital assets	$6,642,505
Amortization expense of tangible capital assets	*($5,482,587)
	$1,140,228

The changes to accounting and reporting requirements under PSAB are a financial accounting treatment only and do not affect operating surpluses. This difference is one of financial statement presentation only.

(Please note that the *marked* financial information provided in this report above, are based on the 2011 Financial Statements.)

Communication Plan/Notice By-law Requirements:
Resolution required.