STAFF REPORT

Meeting Date: March 14, 2022

Title: Ontario Regulation 284/09

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Department: Finance

Report Number: Finance-2022-007

Recommendation:

That Council adopt the 2022 Report on Excluded Expenses as required by Ontario Regulation 284/09, attached as Appendix A.

Background:

In 2009, the province approved legislation that changed the financial reporting and budget requirements for municipalities.

Because of the new requirements, municipalities were to prepare annual Financial Statements in accordance with generally accepted accounting principles (GAAP) 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.

With the implementation of these new accounting rules, municipalities must record amortization on tangible capital assets as 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.

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 the following expenses from their annual budget:

1. Amortization expenses
2. Post-employment benefit expenses
3. Solid waste landfill and post-closure expenses

For 2011 and subsequent years, if a municipality has adopted a budget that excluded any of the expenses listed above, the municipality must prepare a report about the excluded expenses and adopt the report by resolution of Council.

The Regulation requires that the report contain information regarding:

1. An estimate of the change in the accumulated surplus/(deficit) of the municipality to the end of the year resulting from the exclusion of any of those expenses; and
2. An analysis of the estimated impact of the exclusion of any of those expenses on the future tangible capital asset funding requirements of the municipality.

Discussion:

The City of Dryden, like most municipalities in Ontario, continues to prepare budgets based on the traditional cash basis.

The Municipality's 2022 budget and associated tax levy excluded the following:

1. Amortization expenses of ~$4.75M since amortization is a non-cash expense.

The 2022 budget does include the current year's post-employment benefit expenses for the City's eligible retired employees and the solid waste landfill closure and post-closure expenses (capital and operating related to the former Barclay site).

<u>Reporting Requirement #1</u>

Appendix A presents the 2022 Budget, adjusting for transfers to and from reserve, capital asset acquisitions budgeted in 2022, proceeds from debt, debt principal repayment and amortization for the purposes of financial reporting. For this exercise, the net result of all the adjustments is an estimated deficit of $394K which would impact the Municipality's accumulated surplus/(deficit) on the balance sheet.

Please note that the Ontario Regulation 284/09 Report is a financial restatement based on the accrual method and is not the same as the annual operating surplus/(deficit) that occurs at year-end. Monthly financial reports provided to managers and quarterly financial reports provided to Council will continue to be the primary management reporting procedure.

Including the full amortization expenses in the 2022 budget would have required additional revenue/funding of approximately $4.75M, which would have meant a levy increase of ~$5.32M (~39.4% increase) instead of the $570,000 increase budgeted in 2022. In that regard, this levy increase illustrates only the impact of including the amortization cost of tangible capital assets, which is based on the cost of when these assets were first built or purchased and not necessarily the current cost to replace. Therefore, even if the amortization was fully funded, there would likely be a shortfall of funds when the asset replacement is required based on cost increases.

Reporting Requirement #2

Inclusion of tangible capital asset information in the financial statements can assist in understanding the obligation to maintain, renew and replace assets. The amount provided in the 2022 budget for capital purposes (~$7.65M) can be compared to the estimated amount of amortization ($4.75M) to determine whether the city has adequately provided for its capital needs.

However, the weaknesses of using amortization as an indicator of appropriate capital funding include:

1. Assets that are fully depreciated/amortized will not be included.
2. Amortization is based on the historical cost of the tangible capital asset and not the replacement costs, which may be higher due to inflation or changing standards or needs (i.e., accessibility, climate change, demographics, etc.).
3. In-year current amortization is not a good measure of estimating future capital requirements (e.g., growth-related infrastructure would not be captured).

Accounting and reporting on the tangible capital assets will provide information, but it does not provide the full scope required to appropriately determine needs and if annual funding allocations are sufficient. A comprehensive analysis using expected replacement values, condition assessments and corresponding useful life projections can provide a better picture of the City's infrastructure deficit and future needs.

The latest Asset Management Plan (AMP) reports replacement value of City's Assets at $361M (in 2016 dollars). The Report showed an infrastructure deficit of $45M as at year-end 2016, representing assets that have exceeded their useful life. The report also suggested that an average annual investment of $13M is required to maintain the municipality's assets.

The City's AMP shows that current annual contributions are inadequate to maintain the lifecycle replacement requirements of the City's capital asset base over the long term. The infrastructure deficit can be proactively managed by considering the various financial strategies as presented in the City's Asset Management Plan. However, it is critical to include all sources of infrastructure funding when developing financial plans and it will be imperative to secure Federal and Provincial grants to minimize the burden on property taxpayers. Although budget constraints defer replacement of many City infrastructure assets or required improvements, staff will continue working towards securing adequate funding as well as long term planning required to replace assets and address deficiencies moving forward.

Financial Implications:

There are no direct financial implications associated with this report. The information contained in this report will be used to meet the requirements of the Regulation but will not result in any budget to actual variances.

If Council determines that they wish to budget for amortization, which would remove any Regulation 284/09 reporting, there would be significant financial implications to have a balanced budget.

Attachments (Reference Material):

- Appendix A – 2022 Regulation 284/09 Report