

**REPORT FOR ACTION****Additional City of Toronto Reporting Requirement as a Result of Ontario Regulation 286/09, Budget Matters - Expenses**

Date: January 9, 2020
To: Budget Committee
From: Chief Financial Officer and Treasurer
Wards: All

SUMMARY

Ontario Regulation 286/09 "Budget Matters - Expenses" (Regulation) allows the City of Toronto (City) to exclude amortization expense, post-employment benefit expenses and solid waste landfill closure and post-closure expenses when preparing its annual budget. However, the Regulation requires that the City prepare a report which includes at a minimum, an estimate of the change in accumulated surplus resulting from the exclusion of the noted expenses from the budget, and an analysis of the impact of the exclusion on future capital asset funding requirements. The Regulation requires that this report be adopted by City Council (Council) prior to the adoption of its annual budget.

This report discusses the impact of excluding amortization expense, post-employment benefit expenses and solid waste landfill closure and post-closure expenses from the City's budget, along with the impact of the differences between how the City treats the purchase of tangible capital assets, debt principal repayments, Government Business Enterprise (GBE) earnings, and expenses arising from contaminated site liabilities for budgeting and financial reporting purposes. The items treated differently for accounting versus budget purposes, beyond those identified in the Regulation, are included to reflect the complete impact on estimated accumulated surplus for 2020.

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. City Council receive this report for information.

FINANCIAL IMPACT

There are no financial implications as a result of this report.

S. 228 of the City of Toronto Act requires that the City prepare an annual balanced budget, which does not create a budgeted surplus or deficit. The City's 2020 operating and capital budgets include all entities funded through tax and rate based programs, including agencies and corporations.

For financial reporting purposes, an annual surplus or deficit amount can be created when revenues and expenses are accounted for using Public Sector Accounting (PSAB) standards, followed by all levels of government in Canada. The resulting surplus or deficit increases or decreases the City's accumulated surplus. The estimated 2020 accumulated surplus reported in the City's financial statements, resulting from the consolidation of 122 entities and including the financial results of operating and capital activities, Water and Solid Waste and all agencies and corporations, is estimated to increase by \$2.456 Billion to a projected \$29.853 Billion and is comprised mostly of the City's investment in tangible capital assets required for service delivery.

It is important to note that the estimated surplus noted above of \$2.456 Billion dollars is an accounting surplus. It ultimately represents and is triggered by the City's requirement to capitalize capital assets on the balance sheet and amortize them to operations over the useful life of the City's assets. This accounting surplus does not reflect cash available to support 2020 cash outlays within the 2020 Budget.

DECISION HISTORY

As required by the Regulation, this report has been provided to Budget Committee annually since 2010.

To view the last two reports on-line, please follow the hyperlinks below:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.BU41.2>

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.BU3.5>

COMMENTS

The City's 2020 operating and capital budgets are prepared on a modified cash basis, based on the cash revenues the City expects to receive and the cash expenses it expects to pay, along with limited accruals which represent amounts expected or incurred in the year of the budget, but not actually received or paid until after the respective fiscal year end. As a result, the City's operating and capital budgets include cash inflows/outflows for capital asset expenditures, debt issuance and repayment and

amounts paid in the current year for post-employment benefits and landfill closure and post-closure upkeep.

On the other hand, since 2009, the City's financial statements are prepared in accordance with PSAB standards, which require that governments apply full accrual accounting for all assets and liabilities. Following PSAB standards, the assets and liabilities of a government entity are recorded based on receipts and obligations, expected, but not limited to the current year, such that the financial statements recognize revenues and expenses based on what was actually paid during the year, along with benefits and obligations that will result in cash receipts or payments into the future. Assets and liabilities are recorded on the City's Statement of Financial Position (Balance Sheet), which reflects how well off the City is as a result of past investments and future obligations. As a result, capital expenditures that are City assets are capitalized, with the asset value expensed over the life of the asset as amortization. In addition, debt issuance is recorded as a liability that requires future payment. Finally, post-employment benefits and other future liabilities are recorded as obligations using the present value of the future cost.

The preparation of government financial statements all follow the same accounting standards, increasing transparency and comparability, and recognizing not only how well the government entity did against their plan (the modified cash budget), but whether the government entity was better or worse off because of that plan.

The table below outlines the difference between how the City treats the expenses identified in the Regulation, along with other PSAB reporting, for budgeting and financial statement reporting. This information will assist in understanding the impact that the expenses have on the accumulated surplus balance.

Item	Budget Treatment	Financial Reporting Treatment
Capital asset expenditures	Budget annual cash required to purchase or build	Expenditures that qualify as capital assets are capitalized on the Balance Sheet
Amortization	Not budgeted as allowed by the Regulation	Expensed based on the service life of the capitalized asset
Debt issuance and repayment	Budget cash from debt issuance as a cash source and budget for repayment as a cash outlay	Issuance and repayment is an exchange of funds and only impacts the Balance Sheet
GBE earnings	Budget expected dividend distribution as a cash source	Record equity in excess of dividend distribution as a revenue

Item	Budget Treatment	Financial Reporting Treatment
Post-employment benefit expenses	Not budgeted as allowed by the Regulation	Expense the amount created by the employees' service during the year to achieve the liability required upon retirement.
Landfill closure and post closure expenses, Contaminated Sites	Not budgeted as allowed by the Regulation	Expense the amount created by operations during the year to achieve the liability required upon closure of the landfill.

Change in Accumulated Surplus from Excluded and Other Items

Accumulated surplus is a term used in government financial reporting which mirrors retained earnings in the private sector. The largest component of the City's accumulated surplus is related to its investment in tangible capital assets.

The table below estimates the impact of the change in accumulated surplus for the 2020 fiscal year, factoring in revenues and expenditures excluded from the City's modified cash budget:

	\$000's	\$000's
Est. accumulated surplus, consolidated Dec 31, 2019		27,396,737
Impact of tangible capital assets:		
Estimated capital asset expenditures	3,511,000	
Amortization	(1,267,000)	
Debt principal repayments	336,000	2,580,000
Impact of government business enterprises:		
Est. Earnings from Government Business Enterprises	91,000	91,000
Impact of post-employment benefits:		
Estimated increase in employee benefits liability	(129,000)	(129,000)
Impact of active and post-closure landfill liabilities:		
Estimated increase in landfill active and post-closure costs	(28,000)	(28,000)
Impact of contaminated sites:		
Estimated increase in contaminated sites costs	(58,000)	(58,000)
Estimated Surplus for Accounting Purposes		2,456,000
Est. accumulated surplus, consolidated Dec 31, 2020		29,852,737

In summary, the December 31, 2019 accumulated surplus balance, estimated at this time as year-end is not yet finalized:

- Increases by cash expenditures from asset purchases, debt repayment and GBE earnings greater than the dividend distribution, and

- Decreases by future liability estimates for post-employment employee benefits, active and post-closure landfill costs and contaminated site costs

The estimated 2020 accounting surplus arising from the expenses excluded by the Regulation and other financial reporting entries is \$2.456 Billion, which increases the City's accumulated surplus for financial statement reporting purposes to an estimated \$29.853 Billion at December 31, 2020.

The existing process for capital, through the City's Ten Year Capital Program, and operating budgets, provides for a transparent process to commit funds for current and future years. Budget reports, the Annual Financial Report, reports of progress against the City's Long-Term Fiscal Plan, and additional reports on various initiatives, provide detailed information about the City's financial performance which assists users of the information in understanding the financial position of the City.

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SIGNATURE

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