IMPACT OF BUDGETING FOR AMORTIZATION AND POST-EMPLOYMENT EXPENSES

Recommendation

The Commissioner of Finance/City Treasurer recommends:

That this report be received for information purposes.

Economic Impact

This report discusses amortization expenses and post-employment benefit expenses. Staff will provide further information to Council during the 2011 Budget discussions regarding the impact of current capital/reserve funding levels, and approaches to funding future replacement of tangible capital assets and post-employment benefits. Funding these future-oriented expenses will impact tax rates and user fees.

Communications Plan

N/A

Purpose

To provide Council with a report discussing the impact of excluding amortization expenses and post-employment benefit expenses in the 2011 budget, as per Ontario Regulation 284/09.

Background - Analysis and Options

All municipalities including the City of Vaughan prepared their 2009 Financial Statements under the new Public Sector Accounting Board Standards (PSAB), which require the reporting of the historical cost of the municipality's capital assets, the accumulated amortization and the annual amortization expense on the annual financial statements. Amortization (or depreciation) expense reflects the cost of using an asset over the life of the asset. Historically, the City of Vaughan (and other municipalities in Ontario) was not required to budget for amortization expense based on historical costs in annual budgets, but has rather budgeted for contributions to reserves and capital expenses based on analysis of short-term and long-term replacement cost, and affordability to the taxpayer. As a result of the City's policies, the City has accumulated significant reserves per capita relative to other Ontario municipalities.

In 2009, Ontario Regulation 284/09 – "Budget Matters – Expenses" was issued, not requiring municipalities to budget for these items and to continue excluding expenses for amortization, post-employment benefit expenses and solid waste landfill closure and post-closure expenses from budgets, however, the regulation does require that municipal staff prepare a report about the excluded expenses to council within 60 days of receiving the audited financial statements for 2009. The report must contain:

1. An estimate of the change in the accumulated surplus of the municipality at the end of the year resulting from the exclusion of any of the expenses listed.
2. An analysis of the estimated impact of the exclusion of any of the expenses listed on the future tangible capital asset funding requirements of the municipality.

Requirement #1

In response to the first requirement, accumulated surplus is a balance sheet account included in financial statements, and is not normally dealt with in budget deliberations. The 2009 financial statements did reflect the full amount of amortization expense ($54 million) and post-employment benefit expense ($5.6 million) against the accumulated surplus ($6.9 billion), as will the 2010 financial statements. Staff will be following up with Provincial staff to clarify this requirement.

The annual impact of budgeting for amortization expense and post-employment benefit expenses is discussed below under Requirement #2.

Finally, the City of Vaughan does not currently have any liability for solid waste landfill closure and post–closure expenses.

Requirement #2

In response to the second requirement, the City of Vaughan recognised the importance of long-range financial planning and an infrastructure funding strategy as far back as 1994, resulting in a substantial increase in both non-discretionary and discretionary reserves. It has been recognized and reported to Council that there is a funding gap between the funds that will be available for infrastructure replacement based on current funding of reserves and other capital funding, and the future funds that will be required.

In theory, accumulated amortization can be compared to accumulated discretionary reserves. Also, annual amortization expense can be theoretically compared to annual budgeted contributions to reserves and capital, and annual budgeted debt financing. The challenge with this comparison is that amortization is based on historical cost equally allocated over the estimated life of asset, whereas contributions to reserves and debt financing are more aligned to forecast future replacement costs, capital spending requirements based on multi-year forecasts, assessment of asset condition, available grant programs, etc.

The annual amortization expense reported on the City of Vaughan 2009 financial statement under PSAB is $54 million. The asset classes comprising the majority of the $54 million annual expense are Roads Infrastructure (annual amortization expense of $22 million) and Water/Wastewater (annual amortization expense of $17 million). The 2010 budgeted contributions from the operating budget to reserves and capital, as well as debt repayment, is $30 million (not including a $3 million transfer to Hospital reserve). Using an estimated 2010 amortization expense of $55 million, the difference between $55 million and the budgeted $30 million could therefore, in theory, be interpreted as representing an infrastructure replacement funding shortfall of $25 million.

Post-employment benefit expense reported on the 2009 financial statements was $5.6 million. The 2010 Operating Budget includes a $500,000 contribution to the Employee Benefits Reserve established for this purpose. Again, using an estimated 2010 post employment expense of $6 million, the difference between the $6 million and the budgeted $0.5 million could therefore be interpreted as representing a funding shortfall of $5.5 million. There would be a significant impact to property tax rates and user fees if the entire combined $30.5 million ($25 million for infrastructure replacement and $5.5 million for post-employment benefit expense) were to be included as a budgeted expense in 2011.

The City of Vaughan has been proactively creating an inventory of assets, assessing their useful life, replacement costs and modelling alternative funding strategies. To begin to address the forecasted capital asset funding shortfall, the City has already implemented several initiatives. Policy limiting the use of cash accumulated in reserve funds, and policy regarding the transfer of annual operating surpluses has strengthened the City's discretionary reserve balances. Currently underway is the City of Vaughan Financial Master Plan, which includes the phasing-in of multi-year budgets and analysis of future renewal requirements. Additionally, a Consolidated Six Year Water Financial Plan was completed in June 2010, with annual water rate increases, as the water rate moves to a full cost recovery position over ten years. A similar plan will be developed for the Wastewater system.

As part of the 2011 budget process, staff will provide further information to Council regarding the impact of excluding expenses for amortization and post-employment benefit expenses during the 2011 budget discussions.

Relationship to Vaughan Vision 2020

This report is consistent with the priorities previously set by Council and the necessary resources have been allocated and approved.

Regional Implications

Not applicable

Conclusion

Continuing the work relating to the Financial Master Plan, the development of multi-year budgets, and development and monitoring of consolidated six year water and wastewater financial plans will evolve into a future tangible capital asset funding strategy, a long term debt financing strategy and will provide the necessary data to support increases to reserve and capital contribution levels.

Attachments

N/A

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Respectfully submitted,

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