

IMPACT OF BUDGETING FOR AMORTIZATION AND POST-EMPLOYMENT EXPENSES

Recommendation

The Commissioner of Finance/City Treasurer and Director of Budgeting and Financial Planning recommend:

- 1) That the following update on the impact of budgeting for amortization and post-employment expenses be received for information purposes;
- 2) That subject to amendments by the Finance and Administration Committee, the report be forwarded to the Special Council meeting of May 7, 2012 for consideration and adoption.

Economic Impact

This report discusses estimated amortization expenses and post-employment benefit expenses that are excluded from the 2012 Operating Budget and the 2012 Water and Wastewater Budget. Ontario Regulation 284/09 of the Municipal Act allows a municipality to exclude amortization expenses, post-employment benefit expenses and solid waste landfill closure and post-closure expenses from the annual budget estimates as long as Council is advised in a report of the excluded expenses. A decision to fund these future-oriented expenses will impact tax rates and user fees.

Communications Plan

The impact of amortization expenses and post-employment benefit expenses are disclosed on the City of Vaughan annual consolidated financial statements, as required under the new Public Sector Accounting Board (PSAB) standards.

Purpose

To provide Council with a report discussing the impact of excluding amortization expenses and post-employment benefit expenses in the 2012 Operating Budget and the 2012 Water and Wastewater Budget, as per Ontario Regulation 284/09.

Background - Analysis and Options

The Province of Ontario enacted regulation 284/09 of the Municipal Act allowing for certain expenses to be excluded from municipal budgets but with a required reporting disclosure.

As of 2009, all municipalities including the City of Vaughan must prepare their 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 useful 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 had 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 reserves per capita that are higher than average, relative to other Ontario municipalities.

Ontario Regulation 284/09 – "Budget Matters – Expenses" states that municipalities may exclude from annual budgets all or a portion of expenses for amortization, post-employment benefit

expenses and solid waste landfill closure and post-closure expenses, however, the regulation does require a municipality to prepare a report about the excluded expenses and adopt the report by resolution. . This report must contain the following:

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.

The City of Vaughan has developed its 2012 Operating Budget and its 2012 Water and Wastewater budget excluding full amortization and post employment benefits. Solid waste landfill closure and post closure expenses are not applicable to Vaughan's current operations.

Prior year annual amortization expenses can be theoretically compared to current annual budgeted renewal contributions and annual debt financing. One challenge with this comparison is amortization is based on historical cost equally allocated over the estimated life of asset, whereas renewal contributions and debt financing are more aligned with forecasted replacement costs, future capital spending requirements, asset condition assessments, available grant programs, etc.

The post employment benefits are certain health, dental and life insurance benefits that will be paid by the City on behalf of its retired employees. The projected benefit obligation and the annual expense required to fully fund the obligation for active employees and retirees is recognized and reflected in the City's annual financial statements, but is not fully funded through the City's 2012 Operating Budget or the 2012 Water and Wastewater Budget.

The City of Vaughan's 2012 Operating Budget and Water/Waste Water Budget have been prepared as follows:

1. The 2012 Operating Budget includes asset renewal reserve contributions of \$6.2 million and debenture payments, primarily for road renewal, in the amount of \$12.4m. It does not include a full tangible capital asset amortization expense, estimated at \$43.6 million for 2011.
2. The 2012 Water and Wastewater Budget includes reserve contributions of \$10 million for capital asset replacement. It does not include a full tangible capital asset amortization expense, estimated at \$17.9 million for 2011.
3. The 2012 Operating & Water/Water Water Budgets include a post employment benefit expenses totalling of \$1.0 million, which is only a portion of the 2012 annual post employment amortized benefit costs, estimated at \$8.9 million.
4. The City of Vaughan is not subject to solid waste landfill closure and post-closure expenses.

Estimate of the Change in Accumulated Surplus

The difference between estimated amortization expense and budgeted funding is illustrated in the chart below:

Funding vs. Amortization <i>(In Millions)</i>	Annual Budget Funding	Prior Year Amortization	Gap
Asset Renewal			
City Operations	18.6	43.6	25.0
Water/Waste Water	10.0	17.9	7.9
Subtotal Assets	28.6	61.5	32.9
Post Employment Benefits	1.0	8.9	7.9
Combined	29.6	70.4	40.8

As illustrated, the accumulated surplus of the municipality at the end of 2012 would be reduced by approximately \$41 million, if the City budgeted for full amortization expenses and the full cost of post employment expenses.

This reporting requirement has recently been introduced by the Province for all municipalities. However, for the past number of years and prior to any Provincial requirement, Vaughan has been assessing these impacts and developing strategies that have lead to the City's strong financial position.

Estimate of Impact of Excluding Amortization and Post Employment Expense

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 levels and future funds that will be required.

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. For example, policies which limit the use of cash accumulated in reserve funds, and policies regarding the transfer of annual operating surpluses, which has strengthened the City's discretionary reserve balances. In addition, Council recently approved a new "Infrastructure Renewal Policy" which is founded on the below principles:

1. When new infrastructure capital projects are approved, an annual contribution based on lifecycle replacement principals is added to the operating budget for replacement purposes.
2. That an inflationary adjustment be added annually to existing contributions based on historical costs to ensure contributions keep pace with future values.

Currently underway is the City's Financial Master Plan, which includes the phasing-in of multi-year budgets and analysis of future renewal requirements. City staff continue to work on the infrastructure replacement challenge and plan to bring forward more discussion and policies on this topic later this year, as part of the Financial Master Plan report and document. The development of infrastructure funding policies on a go forward basis for municipal infrastructure

will ensure the funding for their eventual replacement is secure, safeguarding the foundation of our community and municipal services.

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

This report provides the information necessary to provide disclosure under Ontario regulation 284/09 that requires municipalities to report to Council when certain expenses are excluded from the budget and the impact on the overall accumulated surplus of such transactions.

Attachments

N/A

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