

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 estimated amortization expenses (excluding water and wastewater) and post-employment benefit expenses that are excluded from the 2011 Operating 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 2011 Operating 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 significant reserves per capita 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 before adopting a budget. 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 2011 Operating Budget (not including water and wastewater) excluding amortization, full post employment benefits and solid waste landfill closure and post closure expenses.

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 post employment benefits are certain health, dental and life insurance benefits 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 2011 Operating Budget.

The City of Vaughan's 2011 Operating Budget has been prepared as follows:

1. The 2011 Operating Budget includes reserve contributions of \$10.8 million for capital asset replacement. It does not include an expense for the amortization of tangible capital assets of approximately \$38.5 million.
2. The budget The 2011 Operating Budget does include an expense of \$0.5 for post employment benefits, a portion of the total estimated 2011 post employment benefits cost of \$6.0 million.
3. 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 of \$38.5 million and reserve contributions of \$10.8 million indicates a 2011 funding gap of \$27.7 million. The estimated funding gap for post employment benefits is \$5.5 million. In simple terms, the accumulated surplus of the municipality at the end of 2011 would be reduced by \$33.2 million if the City of Vaughan budgeted for 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 of reserves and other capital funding, and the 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. 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. Staff continues 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 new 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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