TIP SHEET 2: MEETING REQUIREMENTS OF ONTARIO REGULATION 284/09

Introduction

Since 2009, changes by the Public Sector Accounting Board (PSAB) require municipalities to report on Tangible Capital Assets (TCA) and record TCA in the statement of financial position, and amortize the asset over its useful life in the statement of operations. This has implications for municipal budgeting, as amortization expenses need to be considered for replacement when preparing a budget. Similarly, post-employment benefits and solid waste landfill closure expenses must be considered by municipalities when preparing budgets, as they are also captured by PSAB standards. In light of the new PSAB standards, the *Municipal Act, 2001* was amended and a regulation passed to address these changes. *Ontario Regulation 284/09* (Budget Matters-Expenses) states that a municipality may exclude certain expenses (amortization expenses, post-employment benefit expenses and solid waste landfill closure and post-closure expenses) from the budgeted amounts for which revenue must be raised during this transitory period. If excluded, the regulation requires councils to adopt annual reports that show the impact of fully covering the estimated costs of these expenses. Additionally, the annual reports must be prepared and adopted by council resolution before approving a municipal budget. The annual reports must include:

1. an estimate of the change in the accumulated surplus of the municipality to the end of the year resulting from the excluded expenses; and
2. an analysis of the estimated impact of the exclusion of any of the expenses on the future tangible capital asset funding requirements of the municipality.

The regulation may assist municipalities in the transition to incorporating full accrual accounting in the budgeting process while PSAB standards are being adopted.

A full response to the 2013 review of Regulation 284/09 was undertaken by MFOA. The document pertaining to this review can be located through the link below:

MFOA Response

This tip sheet will help guide municipal administrators prepare their annual report. Generally, the issue with reporting on these expenses is around the use of amortization as a benchmark for future sustainable asset management planning, which in many municipal jurisdictions does not work.

The weaknesses of using amortization as an indicator of appropriate capital funding include:

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

What steps should be followed to complete the annual report?

The following tables summarize a step-by-step approach and outline to estimate the change in accumulated surplus resulting from the excluded expenses. Two examples are provided:

Example 1:

Outline for Conversion from *Fund* to *Accrual* Accounting		**Notes:**
Operating Budget Surplus/(Shortfall) - Fund Accounting		
1. Capital Assets		
• *Less:* Amortization Expense		May be estimated by using the previous years amortization expense then deducting the amortization related to disposals in the current year and adding the amortization of assets to be acquired.
• *Add:* Budgeted Tangible Capital Asset Acquisitions		Ensure non-TCA expenditures are not included in this figure.
• *Less:* Proceeds of Debentures		Debt proceeds are considered a liability and not a revenue source under accrual accounting.
• *Add:* Debt Principal Payments		Under the accrual method, debt principal payments are considered a reduction of the liability and not an expense.
• *Add:* Transfer to Reserves		Under the accrual method, contributions to reserves are not considered an expense.
• *Less:* Transfer from Reserves		Under the accrual method, contributions from reserves are not considered a revenue.
2. Post-Employment Benefits		
• *Less:* Change in Unfunded Post Employment Benefits Liability		Under full accrual accounting, any amounts expected to be paid on behalf of employees on or after retirement will be expenses throughout the employee's active service life. Post-Employment benefits include the following: • Continuation of health benefits after retirement • WSIB partial disability pensions to former employees • Payout of frozen sick leave credits on retirement
3. Post-Closure Landfill Expenses		
• *Less:* Change in Unfunded Landfill Closure and Post Closure Liability		The reporting of landfill closure and post closure expenses reduce the accumulated surplus.
Estimated Impact on the Ending Accumulated Surplus		

Example 2:

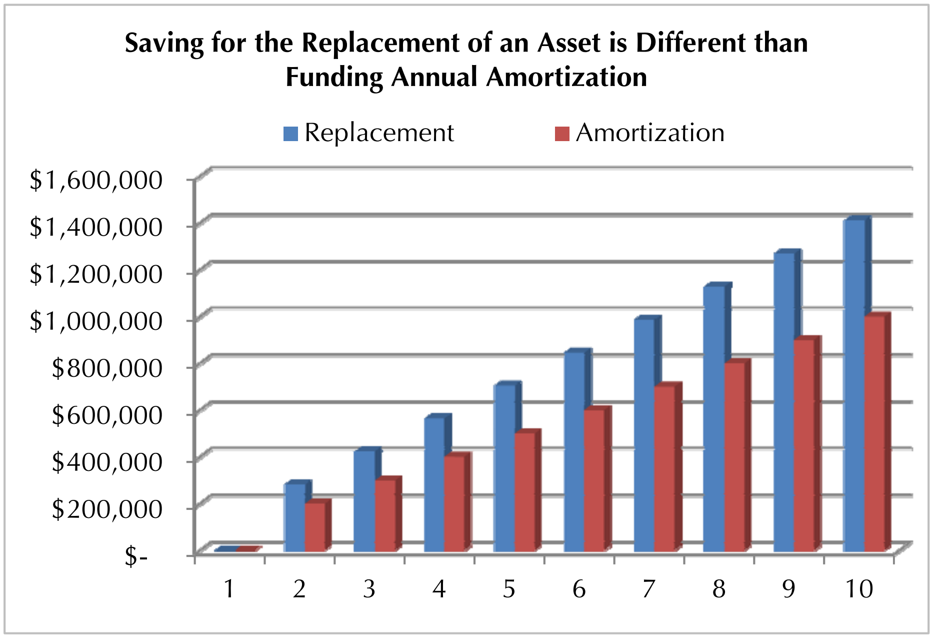
Outline for Conversion from *Fund* to *Accrual* Accounting		
Revenues		
Operating		As per the proposed budget
Capital		As per the proposed budget
Less:		
Transfer from other funds		This figure represents transfers from reserves/reserve funds for expenditures, these funds are not considered a revenue source under accrual accounting.
Proceeds on long term debt issue		Debt proceeds are considered a liability and not a revenue source under accrual accounting.
Total Revenues		
Expenses		
Operating		As per the proposed budget
Capital		As per the proposed budget
Less:		
Transfer to other funds		Under the accrual method, contributions to reserves are not considered an expense.
Tangible Capital Assets		Under the accrual method, Tangible capital assets are not fully expensed in the year of acquisition, instead they are amortized over their useful life.
Debt Principal Payments		Under the accrual method, debt principal payments are considered a reduction of the liability and not an expense.
Total Expenses		
Annual Surplus: before exclusions		Revenues less Expenses
Exclusions:		
Less: Amortization of TCA		Estimated
Add: Post-Closure Landfill Expenses		The reporting of landfill closure and post closure expenses reduce the accumulated surplus.
Add: Post-Employment Benefit Expenses		Under full accrual accounting, any amounts expected to be paid on behalf of employees on or after retirement will be expenses throughout the employee's active service life. This figure represents the increase in the Post-Employment Benefits Liability.
Total Exclusions:		
Annual Surplus: after exclusions		

Although not required under the regulation, the municipality may also consider including a funding impact statement in the report. The statement would identify any implications if the noted expenditures were included in the budget.

For example: Including the full amortization, post-employment and post-closure land fill expenses in the 2014 budget would have required additional funding of approximately *xx million*, which would have meant a tax rate increase of *xx%* instead of the *yy%* increase levied. In that regard, this rate 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 repair or replace the asset. Therefore, even if the amortization is fully funded, there will likely be a shortfall of funds when the asset is required.

Example:
Comparing amortization vs. replacement cost saving. Gap that exists if a municipality were to fund solely the amortization expense when the asset was acquired.

Assumptions:
2014 Cost: $1,000,000
Useful Life: 10 Years (replacement in 2024)
Replacement cost: $1.4 million



- In ten years, if the asset would require replacement, a shortfall in excess of $400,000 would be realized

- Funding solely the amortization can be seen as partial funding for the ultimate repair and replacement of an asset

- Amortization funding is not an accurate reflection of long-term capital financing requirements

2) How to estimate the impact of the exclusion of any of the expenses on the future funding requirements of the municipality?

In order to meet the second reporting requirement, municipalities should compare existing funding levels to required future funding needs. The following steps can help a municipality estimate the impact of the excluded expenses on future funding needs of the municipality. In order to comply with the second reporting requirement your municipality should:

1) Document existing funding levels. This should include the actual amount your municipality spends on related activity and any provisions to reserve for the future needs.

2) Identify how much you should be investing each year. This should include in-year requirements and the provision for the future needs.
    a. As part of this process, your municipality could rely on documents which have identified a need to increase (or decrease if applicable) current funding. These documents could include Long-Range Financial Plans for tax and rate supported programs.