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Halifax Regional Council
July 6, 2004

TO: Mayor Kelly and Members of Halifax Regional Council

SUBMITTED BY: Jan Gibson
for Councillor Ron Cooper, Chair Audit Committee

DATE: June 8, 2004

SUBJECT: New Financial Accounting and Reporting Principles
Public Sector Accounting Board (PSAB) Recommendations

ORIGIN

Audit Committee meeting regarding discussion of the September 2003 changes to the Canadian Institute of Chartered Accountant's (CICA) assurance standards and March 2004 correspondence from Service Nova Scotia and Municipal Relations regarding municipalities in Nova Scotia compliance with the CICA's Public Sector Accounting Board's (PSAB) recommendations.

RECOMMENDATION:

It is recommended that:

- Staff provide Regional Council with audited financial statements on a basis consistent with prior years' accounting policies on July 13, 2004 to meet the legislative requirement to have audited financial statements on file at Service Nova Scotia and Municipal Relations by July 31, 2004, and,
- Financial statements in compliance with the CICA's Public Sector Accounting Board's recommendations be prepared for the fiscal year ending March 31, 2005 with quarterly updates to Council in conjunction with the quarterly reports throughout fiscal 2004/05.

BACKGROUND

The Public Sector Accounting Board (PSAB) is authorized by the Board of Directors of the Canadian Institute of Chartered Accountants (CICA) to issue Recommendations and guidance with respect to matters of accounting in the public sector. PSAB is volunteer based and volunteer driven. It includes representation from all levels of government and their auditors. PSAB recommendations have been adopted as the basis of financial reporting for local governments in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario.

Currently HRM is required to budget and report financial results in accordance with the Municipal Accounting and Reporting Manual (MARM). This is prescribed by the regulation made by the Minister of Service Nova Scotia and Municipal Relations (SNSMR) pursuant to Section 451 of the MGA. Also, in accordance with this legislative requirement, the audit opinion for HRM's financial statements identify that the financial statements are prepared "in accordance with generally accepted accounting principles adopted for Nova Scotia Municipalities."

By definition, generally accepted accounting principles (GAAP) is the basis of accounting used for *general purpose* financial statements which are designed to meet the common information needs of external users. When the principles are modified such as in the case of "GAAP adopted for Nova Scotia Municipalities", the financial statements become more specific in use and no longer meet the definition of *general purpose*. Rather it is one of many examples of financial statements prepared using a basis of accounting other than GAAP.

In September 2003, the Canadian Institute of Chartered Accountants (CICA) made revisions to their standards to create a consistent approach to the wording of the auditor's report on financial statements prepared using a basis of accounting other than GAAP. GAAP for all governments in Canada is further defined as the PSAB recommendations, therefore, if the PSAB principles are not applied in the accounting and reporting of government financial statements, the financial statements are, by definition, special purpose, rather than general purpose, and this should be noted in the auditor's report. This revision is in effect for the fiscal year ending March 31, 2004.

Therefore, if municipalities continue to report financial results in accordance with MARM, the financial statements would be prepared using a basis of accounting other than GAAP and, assuming an otherwise unqualified audit opinion, the following additional paragraph would be added to the auditor's report:

"These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are intended for the information and use of _____ and may not be appropriate for any other use." (CICA Section 5600)

In addition, note disclosure on the financial statements would need to be enhanced to disclose the purpose of the financial statements (for the use of Regional Council and Service Nova Scotia and Municipal Relations), the basis of accounting (MARM) and material differences between MARM

and PSAB. These differences need to be identified but need not be quantified.

In response to the recommendations issued by CICA, SNSMR circulated a letter to all municipalities in March 2004 identifying that it needs to begin a comprehensive review of MARM and consider potential impacts on municipalities and on existing legislation, and review options to facilitate a smooth transition. It expects to be in a position to have amended regulations for the 2004/05 financial statements. There is, therefore, no legislative or regulation changes that require a change to PSAB for fiscal 2003/04. The letter from the Department only indicates that it expects that all municipalities and their registered auditors will strive to prepare, and audit, PSAB compliant financial statements for the 2003/04 fiscal year, in order to be consistent with CICA. It does not address compliance with MARM.

DISCUSSION

On a very broad basis, there are three areas of difference between MARM and PSAB:

- Consolidation recommended by MARM, required by PSAB,
- Revenue and expenditures are recognized on a modified accrual basis in MARM, full accrual basis in PSAB, and,
- The basic financial statements in MARM are the Balance Sheet and Statement of Operations; for PSAB - Statement of Financial Position, Statement of Financial Activities and Statement of Changes in Financial Position.

Currently HRM is using the same MARM basis of accounting for reporting and for determining annual funding requirements in order to produce the legislated requirement of a balanced budget. Therefore, there is a year-by-year reporting of revenue and expenditures against budget but no reporting on the overall financial position.

The PSAB Statement of Financial Activities accounts for the difference between revenues and expenditures on a full accrual method. Then, adjustments are included for items that have been accrued but not yet included in the funding calculation to arrive at the change in the fund balances. These statements help identify not only current but also future funding requirements.

The consolidated PSAB financial statements would not replace the separate financial statements of individual funds, agencies, boards and commissions, however, those statements alone do not provide the public and other users with an overview of the full nature and extent of the financial resources and affairs which the Municipality is responsible for.

There are definite benefits to moving to PSAB compliant statements. In addition to clearly identifying current and future funding requirements, PSAB compliant financial reporting ensures the financial statements are general purpose and meet the needs of a broad base of decision makers and improves the comparability with other Canadian municipalities. As HRM moves to a broader debt funding base, statements prepared on a basis understood by a broad range of decision makers becomes increasingly important.

The move to PSAB, however, is not without its challenges. As noted by SNSMR, they are reviewing options to ensure a smooth transition on the legislative front. For HRM to be fully PSAB compliant for fiscal 2003/04 would require a dedication of resources that is not available within the current budget and there is no legislative requirement to do so at this time. Therefore, staff have reviewed options and will be preparing financial results for Council on a basis consistent with prior years, i.e. in accordance with MARM. There will be an additional explanatory paragraph on the auditor's report. However, as noted above, this simply explains the specific use of the financial statements.

Staff would intend to bring the 2003/04 results to Council as in prior years prior to the summer break to meet the legislative requirement to have financial statements on file at SNSMR by July 31. Work will continue on PSAB compliance and in conjunction with the second quarter report in 2004/05, financial results will be brought to Council in a PSAB format in preparation for PSAB compliance for the 2004/05 fiscal year-end.

Major areas requiring review for PSAB compliance include:

- Determination of which financial affairs and resources should be accounted for in the consolidated financial statements. This requires a determination of those organizations that are controlled by HRM where control is defined as the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to HRM from the other organization's activity. HRM's relationship with a number of various organizations will need to be reviewed, including but not limited to those operating HRM facilities under management agreements.
- Determination of the basis of inclusion of a "controlled" organization within the HRM consolidated financial statements.
- Restatement of budget information to be consistent with that used for the actual results.
- Adjustment for accrual of interest on long term debt
- Review of the PSAB accounting and reporting requirements relative to retirement benefits, post-employment benefits and compensated absences.
- Review of the PSAB recognition, measurement and disclosure requirements relative to landfill closure and post-closure liabilities.

Current PSAB requirements for local governments do not extend to Tangible Capital Assets, rather, expenditures on capital assets are reported as expenditures on the statement of financial activities in the period incurred. This is a change from current reporting of capital assets on the capital fund balance sheet until they reach the end of their useful economic life. While Tangible Capital Assets and the need to record and depreciate assets is currently not an area applicable to local governments, it has been identified as an area that is being reviewed for future applicability. As well, from an asset management point of view, staff have identified a need for a comprehensive capital asset listing.

Therefore, work will continue in this area.

BUDGET IMPLICATIONS

Currently, there are no budget implications to reporting financial results at March 31, 2004 on a basis consistent with prior years and working towards PSAB compliant financial statements for March 31, 2005. Changes to the legislation being reviewed by SNSMR may result in some budget implications but the nature of any changes are unknown at this point in time.

FINANCIAL MANAGEMENT POLICIES / BUSINESS PLAN

This report complies with the Municipality's Multi-Year Financial Strategy, the approved Operating, Capital and Reserve budgets, policies and procedures regarding withdrawals from the utilization of Capital and Operating reserves, as well as any relevant legislation.

ALTERNATIVES

Resources could be dedicated to develop PSAB compliant statements for 2003/04. However, there is currently no budget for this activity and there is no legislative requirement yet to make these changes, therefore, staff are not recommending this option. If Council, after reviewing the options, determines PSAB compliance for 2003/04 is the preferred option, there will be unbudgeted costs incurred in the Accounting Division of Financial Services of between \$35,000 and \$100,000. Despite the existence of technical experience within HRM, resources are stretched in this area supporting various disaster recovery work, making acceleration of HRM PSAB compliance earlier than 2004/05 impossible without additional resources.

Alternatively, given that there is no legislative requirement right now to do so, HRM could decide to make no changes in relation to PSAB compliance, wait until the legislative changes are made by the Province and then address the issues relative to PSAB compliance. Given the direction from the CICA and the Province's indication that they will be reviewing the legislative changes for 2004/05 and staff's view that PSAB compliance is a desirable goal, it is prudent to start identifying and quantifying the necessary changes now. In addition, as noted above, there are benefits to providing our financial statements on a basis of accounting that is understood by a broader base of decision makers.

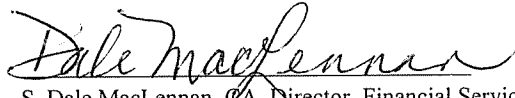
ATTACHMENTS

- Glossary of terms
- Members of PSAB and its task forces
- March 2004 letter to municipalities from SNSMR

Additional copies of this report, and information on its status, can be obtained by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

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Report Approved by:



S. Dale MacLennan, CA, Director, Financial Services 490-6308

Glossary of Terms

CICA	The Canadian Institute of Chartered Accountants conducts research into current business issues and supports the setting of accounting and assurance standards for business, not-for-profit organizations and government. Accounting and assurance standards are included in the CICA handbook.
Full accrual	The accrual basis of accounting recognizes the effect of transactions and events in the period in which the transactions and events occur, regardless of whether there has been a receipt or payment of cash or its equivalent.
GAAP	<p>Generally accepted accounting principles in Canada are the standards included in the CICA handbook. In 1975, the Handbook was incorporated into the Canada Business Corporations Act to be used by every company in Canada when preparing financial statements. In 1981, all organizations in the public and not-for-profit sectors accepted the principles in the Handbook as law and the CICA set up the Public Sector Accounting Board to develop accounting standards for the public sector. Within Nova Scotia the SNSMR Municipal Accounting and Reporting Manual has been defined as “GAAP adopted for Nova Scotia municipalities” and the Handbooks of PSAB and the CICA are referenced as the authoritative source when this manual is silent.</p> <p>The standards in the Handbook emphasize principles rather than detailed rules and, therefore, cannot be phrased to suit all circumstances or combinations of circumstances that may arise.</p>
MARM	The Municipal Accounting and Reporting Manual is a regulation prescribed pursuant to Section 451(1) of the Municipal Government Act as the basis of accounting to be used by municipalities in the Province of Nova Scotia. (“GAAP adopted for Nova Scotia municipalities”)
Modified accrual	Within the Nova Scotia Municipal Accounting and Reporting Manual, modified accrual is defined as full accrual except for the accrued interest on long-term debt. PSAB reporting standards include accrual of other items which have been formerly disclosed only in the notes to the financial statements such as retirement benefits, post-employment benefits, compensated absences and landfill post-closure costs.
PSAB	Public Sector Accounting Board is authorized by the Board of Directors of the CICA to issue Recommendations and guidance with respect to matters of accounting in the public sector.

PSAB Who's Who

Better information for decision-making and accountability

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Our File Number:

Mr. George McLellan
Chief Administrative Officer
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Dear Mr. McLellan:

Service Nova Scotia and Municipal Relations' Municipal Accounting and Reporting Manual (MARM) provides guidance to municipalities on accounting and reporting issues. To ensure that MARM remains a useful tool for both municipalities and the Department, it is reviewed and revised by a committee with representatives from the Association of Municipal Administrators and the Department.

Recent changes to Canadian Institute of Chartered Accountant's (CICA) assurance standards have made it necessary for the committee to begin a comprehensive review of MARM. All areas of non-compliance with the Public Sector Accounting Board (PSAB) Handbook (GAAP for governments in Canada) must be identified and the impacts assessed. There are also many related issues that require careful consideration. For example, Section 72(4) of the *Municipal Government Act* states: "The council shall include in its estimates the deficit from the preceding fiscal year." As was demonstrated at the workshop, the Change in Fund Balance calculated on a consolidation basis in accordance with PSAB can differ significantly from the Operating Fund surplus/deficit calculated in accordance with MARM. The Department must consider potential impacts on municipalities and on existing legislation, and review options to facilitate a smooth transition.

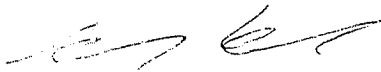
The Department appreciates that some municipalities may have difficulty complying with PSAB in fiscal year 2003/04. It is also aware that municipalities must comply with PSAB, in order to receive an unqualified audit report. The Municipal Accounting and Reporting Manual, which is a regulation pursuant to Section 451(1) of the *Municipal Government Act*, currently requires municipalities to comply with its provisions and cites the Public Sector Accounting Handbook as a source of guidance on matters in which MARM is silent. The Department must consider changes to the regulation, so that municipalities can comply with PSAB, without being in violation of the legislation.

The Department expects that all municipalities and their registered auditors will strive to prepare, and audit, PSAB compliant financial statements for the 2003/04 fiscal year, in order to be consistent with CICA. There may be some municipalities that will have difficulty preparing statements that are 100% PSAB compliant. The Department will work with these municipalities to assist in the development of statements that are as close to PSAB as possible with the goal of obtaining a clean audit report.

Adverse audit opinions can have serious implications for municipalities. Residents and the media may perceive that the municipality is not showing due diligence in protecting the municipality's assets. Lending institutions may view the municipality as a riskier investment and change the terms of their line of credit, or increase interest rates.

Because of the magnitude of the issues and impacts, the committee will not be able to finalize amendments to MARM before fiscal year end. As part of its review process, the committee has been looking at sample formats for financial statement presentation. Links to sample formats will be posted on SNSMR's website at www.gov.ns.ca/snsmr. The Department expects to be in a position to have the amended regulations (MARM) prepared in time for the 2004/05 audited statements.

Yours truly,



Greg Keefe, CMA
Acting Deputy Minister

cc Directors of Finance
AMA
UNSM