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HALIFAX
REGIONAL MUNICIPALITY

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Halifax Regional Council
May 29, 2007

TO: Mayor Kelly and Members of Halifax Regional Council

SUBMITTED BY: Cathie O'Toole

Cathie O'Toole, CGA, A/Director, Finance

DATE: May 15, 2007

SUBJECT: **Changes in Principles of Financial Reporting**

INFORMATION REPORT

ORIGIN

As a result of changes in accounting and assurance standards as well as legislative changes in the system of accounting to be used by municipalities in the Province of Nova Scotia, there are now differences that arise between the operating fund budget that forms the basis for the calculation of the annual tax rates and the year-end audited financial statements. The Audit Committee has requested that clarification be provided to Regional Council on the accounting and reporting requirements and an explanation on HRM's current position re transition.

BACKGROUND

As a result of changes to the Canadian Institute of Chartered Accountant's (CICA) assurance standards in September 2003 as well as the benefits to be derived from preparing HRM's annual financial statements on a basis consistent with other municipalities across Canada, a recommendation to prepare financial statements in compliance with the CICA's Public Sector Accounting Board's (PSAB) recommendations for the fiscal year ending March 31, 2005 was approved by Regional Council on July 6, 2004.

In conjunction with this change in the national assurance standards, the Province was reviewing the Provincial reporting requirements for Nova Scotia municipalities and the Municipal Accounting and Reporting Manual (MARM) was repealed on June 21, 2006 and replaced with the Financial Reporting and Accounting Manual (FRAM).

Prior to these changes, the basis of accounting for the annual budget calculation of the tax rates was the same as the basis used in the annual year-end financial statement preparation. With the changes, however, came changes in the composition of certain amounts to be included in the annual budget estimated requirements. Specifically, municipalities are required to include certain costs in the estimated requirements earlier than previously required. As a result, in the year of transition, there could be significant expenses related to these items. To allow municipalities to incorporate the additional expenses over a reasonable period of time, transitional provisions were included in the new provincial requirements. Accounting and reporting standards require these amounts to be included in the annual year-end financial statements, however, the funding of these amounts through the annual tax rate may now be on a different basis.

The areas where the change in accounting policy resulted in a requirement to recognize costs earlier than might have been done otherwise include:

- accruals related to landfill closure/post-closure costs,
- accruals for post-employment and retirement benefits,
- accruals for interest on long-term debt.

DISCUSSION

For HRM the additional one-time costs recognized in the March 31, 2006 year end financial statements were:

• Landfill closure/post-closure costs	$ 2.0 million
• Post-employment /retirement benefits	$ 2.8 million
• Interest on long-term debt	$ 4.8 million
Total	$ 9.6 million

Funding this in one year's budget would have had a significant impact on the budget options available to HRM and annual tax rate calculations. While the changes in principles require that these amounts be fully accrued and recorded in the annual financial statements, there are options provided in the new Provincial requirements for the funding of these items. Differences between the amount recorded in the financial statements and the amount funded are recorded on the financial statements as an amount to be recovered from future revenues.

Landfill costs

Transitional provisions in the new provincial requirements allow a municipality to recognize the additional costs in the calculation of tax rates at a minimum rate of 20% annually over a period that does not extend beyond March 31, 2012. HRM's total liability for landfill closure and post-closure costs as at March 31, 2006 was $11.9 million of which $9.9 million had been funded in prior years' tax rates. There is a plan in place to fully fund the remaining $2.0 million over a period to March 31, 2011.

Post-employment and retirement benefits

These include costs associated with items such as the retiring allowance program, early retirement programs, other lump sum amounts payable at retirement and pension contributions for employees on long-term disability. HRM's total liability for these costs as at March 31, 2006 was $25.4 million of which $22.6 million has been funded in prior years' tax rates. The remaining amount to be funded from future revenues, $2.8 million, relates to the unfunded lump sum amounts paid to a health trust for retiring police officers and HRM's pension contributions for employees on long-term disability. Transitional provisions in the new provincial requirements allow a municipality to recognize the additional costs in the calculation of tax rates at a minimum rate of 20% annually over a period that does not extend beyond March 31, 2012. All these benefits are actuarially reviewed on an annual basis in conjunction with the preparation of the year-end financial statements. A funding plan is currently being reviewed in conjunction with the March 31, 2007 year-end to ensure the amounts will be fully funded by March 31, 2012 in accordance with the new provincial regulations.

Interest on long-term debt

Interest on long term debt for municipalities has historically been recorded as an expenditure in the financial statements and budgeted as an estimated requirement in the tax rate calculations when the interest was paid (cash basis). The new provincial requirements recommend that municipalities budget for interest on an accrual basis but these new regulations also recognize that interest on an accrual basis would represent a significant change in the policy intent of the "municipality's requirements" for the purpose of tax rate calculations. Therefore, municipalities have the option of budgeting for interest on either a cash basis or an accrual basis. If in any year a municipality elects to recognize interest on an accrual basis in its estimated requirements for the purposes of tax calculations, the municipality must continue to recognize interest on an accrual basis in its estimated requirements from that point forward.

The change from a cash basis to an accrual basis would result in a one-time cost for HRM of approximately $5 million. As a result, HRM continues to budget for interest on long term debt on the cash basis which will result in an on-going difference between the annual operating budget costs and the annual financial statements. This will be identified on the year-end financial statements as an amount to be funded from future revenues.

BUDGET IMPLICATIONS

Budget implications are as noted above and will be dealt with through the transition period for landfill closure and post-closure costs as well as other post-employment and retirement benefits. Maintaining the principle of funding interest on long-term debt on the cash basis results in no budget implications. However, if there is a change to budget interest on an accrual basis, there would be a one-time budget impact of approximately $5 million.

These costs will be reviewed and updated with Regional Council in conjunction with the year-end reporting process and with future annual budget preparations.

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.

ATTACHMENT

None

A copy of this report can be obtained online at http://www.halifax.ca/council/agendasc/cagenda.html then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

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