



Committee of the Whole Report For the Meeting of April 25, 2019

To: Committee of the Whole **Date:** April 9, 2019
From: Susanne Thompson, Deputy City Manager and
Chief Financial Office
Subject: 2018 Financial Statements

RECOMMENDATION

That Council approve the 2018 Financial Statements.

EXECUTIVE SUMMARY

Under section 167 of the Community Charter, a municipality's financial statements must be prepared by its Financial Officer and presented to Council for its acceptance. The 2018 financial statements are the responsibility of management and have been prepared in accordance with "generally accepted accounting principles" for local governments established by the Public Sector Accounting Board.

The information in the Financial Statements can provide indicators of the financial condition of an organization, as will be discussed in this report.

Under section 171 of the Community Charter, the City's Municipal Auditor (BDO) must report to Council on the annual financial statements. The report must be in accordance with the form and the reporting standards recommended by CPA Canada.

As outlined in their audit findings report, the focus areas for this year's audit included risk of management overrides; revenue recognition; capital assets; employee future benefits; salaries and benefits; and cash and investments. All testing was executed as planned and no errors were noted.

BDO has also reviewed a number of financial policies and procedures primarily related to the focus areas listed above and have provided their observations for improvements in the management letter. The suggestions include reviewing indirect taxation processes and documentation for streamlining opportunities, as well as consideration of balancing funding decisions between strategic initiatives and infrastructure asset management. For some of the recommendations, City processes are in place or the suggested components are already being undertaken, however improvements are underway to incorporate recommended actions going forward. Staff appreciate the suggestions provided by the external auditors and welcome their insight towards opportunities to refine our operations in the spirit of continuous improvement.

Once accepted by Council, BDO will issue an Auditor's Report expressing that in their opinion the financial statements present fairly, in all material aspects, the financial position of the City as at December 31, 2018.

PURPOSE

To provide Council with an overview of the City's 2018 audited Financial Statements and request Council's acceptance of the Financial Statements as required by Section 167 of the Community Charter.

BACKGROUND

Section 167 of the Community Charter requires that annual audited financial statements be prepared and presented to Council for acceptance. The City's audited consolidated financial statements for 2018 have been prepared by management in accordance with the generally accepted accounting principles for local governments, as prescribed by the Public Sector Accounting Board (PSAB) of CPA Canada.

Under PSAB reporting requirements, the following statements are presented for Council's review: (page references to Appendix A)



Statement of Financial Position (pg.4) – provides a summary of the City's economic resources (assets net of liability balances) available to meet its obligations and provide services. By continuing to grow its net financial asset position, the City strengthens its capacity to meet financial obligations.



Statement of Operations and Accumulated Surplus (pg.5) – identifies the current year contribution to the Accumulated Surplus balance from revenue and expenses



Statement of Changes in Net Financial Assets (pg.6) – supplementary detail of the changes in assets and liabilities that explain the change to the Net Financial Assets balance on the Statement of Financial Position






Statement of Cash Flows (pg.7) – supplementary detail to support the change to Cash and Cash Equivalents balance on the Statement of Financial Position



Notes to the Financial Statements (pgs.8-32) - additional detail to disclose relevant reporting information and support significant balances in the Financial Statements.

The relationship between the statements are illustrated below (Figure 1): the Statement of Operations and Accumulated Surplus, the Statement of Changes and Net Financial Assets, and the Statement of Cash Flows provide expanded detail on the balances in the Statement of Financial Position.

Figure 1. Relationship between Financial Statements

| The Corporation of the City of Victoria Statement of Financial Position As at December 31, 2018, with comparative figures for 2017 | | | |
|--|-----------------------|-----------------------|---|
| | 2018 | 2017 | |
| Financial Assets | | |  |
| Cash and cash equivalents (Note 2) | \$ 104,955,258 | \$ 110,003,479 | Statement of Cash Flows |
| Accounts receivable | | | |
| Taxes | 1,652,910 | 1,816,637 | |
| Other | 31,117,781 | 31,000,806 | |
| Portfolio investments (Note 4) | 171,000,025 | 137,900,025 | |
| Mortgage receivable (Note 5) | 893,216 | 865,687 | |
| Other assets | 56,774 | 1,799 | |
| Restricted cash (Note 18) | 1,270,467 | 1,243,414 | |
| | <u>310,946,431</u> | <u>282,831,848</u> | |
| Liabilities | | | |
| Accounts payable and accrued liabilities (Note 6) | 28,578,753 | 29,406,144 | Statement of Changes in Net Financial Assets |
| Deposits and prepayments | 17,638,717 | 15,664,116 | |
| Deferred revenue (Note 7) | 30,602,821 | 24,876,181 | |
| Long-term debt (Note 8) | 69,272,953 | 73,250,606 | |
| Employee future benefit liability (Note 9) | 17,896,701 | 17,688,187 | |
| | <u>163,989,945</u> | <u>160,885,235</u> | |
| Net Financial Assets (net debt) | 146,956,486 | 121,946,613 | |
| Non-Financial Assets | | |  |
| Tangible capital assets (Note 10) | 525,021,659 | 495,784,737 | Statement of Operations and Accum Surplus |
| Inventories of supplies | 1,147,765 | 1,045,591 | |
| Prepaid expenses | 2,153,337 | 1,145,524 | |
| | <u>528,322,761</u> | <u>497,975,852</u> | |
| Accumulated Surplus (Note 11) | \$ 675,279,247 | \$ 619,922,465 | |
| The accompanying notes are an integral part of these financial statements. | | |  |

The Statement of Financial Position, accompanied by Note 11 identifying the components of the Accumulated Surplus, provides a snapshot of the City's financial health at a point in time. The Statement shows what the City owns and what it owes.

ISSUES & ANALYSIS

This report identifies the information in the Financial Statements that can be used as indicators of the City's financial condition, and highlights the operational results contributing to the Statement of Financial position at December 31, 2018, addressing areas where Council policy guides decision making.

Indicators of Financial Condition

Financial condition is a government's financial health as assessed by its ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others. Applying indicators of financial condition specific to government organizations offers readers of the financial statements insights into the short and long-term implications of policy decisions, and illustrates a government's financial ability to maintain the level and quality of its services and to finance new programs.

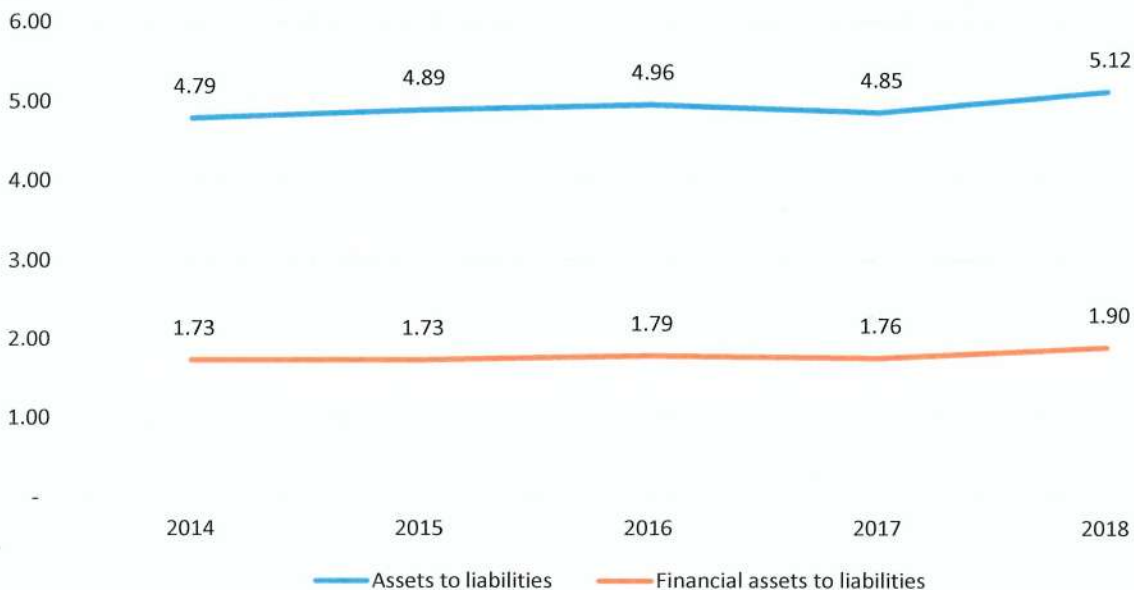
Assessing a government's financial condition using the elements of sustainability, flexibility, and vulnerability, at a minimum, provides a framework to support a variety of strategic and policy decisions.

Sustainability

Sustainability is the degree to which a government can maintain its existing financial obligations both in respect of the service commitment to the public and financial commitment to creditors, employees, and other without increasing the debt or tax burden. The ratio of assets to liabilities illustrates the extent to which a government finances its operations by issuing debt. A ratio of higher than one indicates that a government has accumulated surplus and has assets greater than debt. A ratio of less than one, or downward trending, may not be sustainable. For the ratio of financial assets to liabilities, a result of less than one indicates liabilities in excess of financial assets.

The City's ratio of assets to liabilities, and financial assets to liabilities, are positive and trending upward, to indicate strengthening sustainability: the current revenue is sufficient to cover operating costs; and resources are on hand that can finance future operations.

Figure 2. Sustainability Indicators



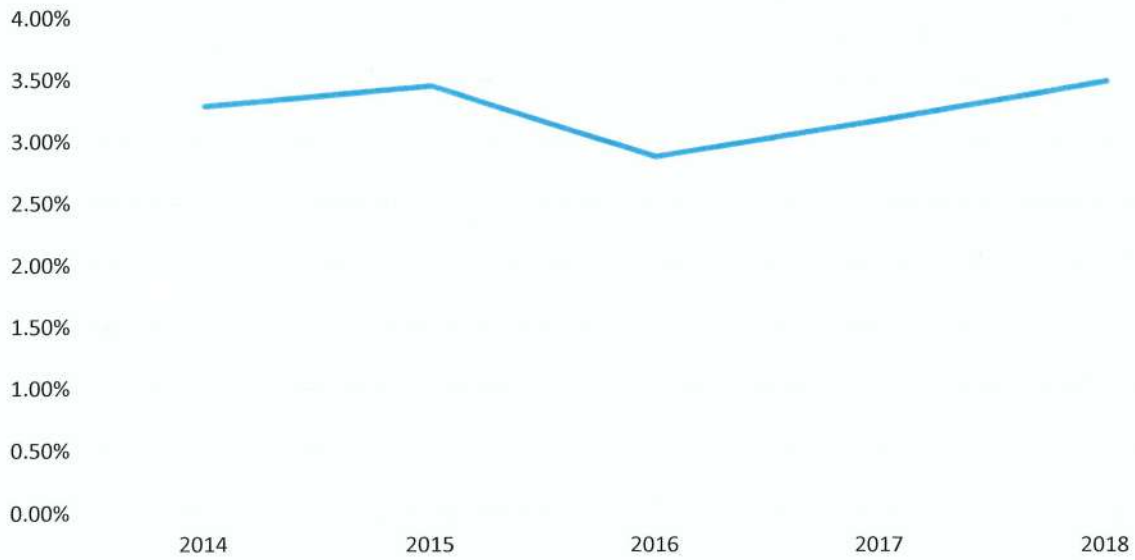
Flexibility

Flexibility refers to the degree to which a government can change its debt or tax burden on the economy within which it operates in order to meet its existing commitments. This provides insights into how a government manages its finances: increasing current borrowing reduces future flexibility to respond when adverse economic circumstances develop; increasing taxation or user fees reduces its ability to do so in the future as a government approaches the limit that citizens and businesses are willing to bear.

Public debt charges to revenues illustrates the extent to which past borrowing decisions present a constraint on a government's ability to meet its financial and services commitment in the current period. The more a government uses revenues to meet the interest costs on past borrowing, the less it will be available for program spending.

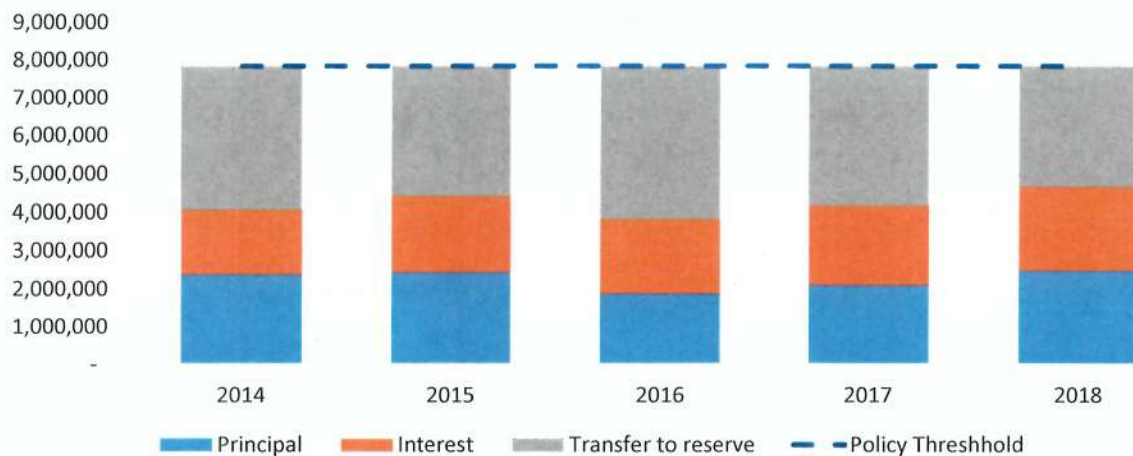
The City's external debt service costs include principal repayment and interest costs. The ratio of debt service costs to taxation revenue fluctuates in response to new debt issues, changes to interest rates, and debt issue maturity.

Figure 3. Debt Service Costs (principal repayment and interest costs) to Taxation Revenue



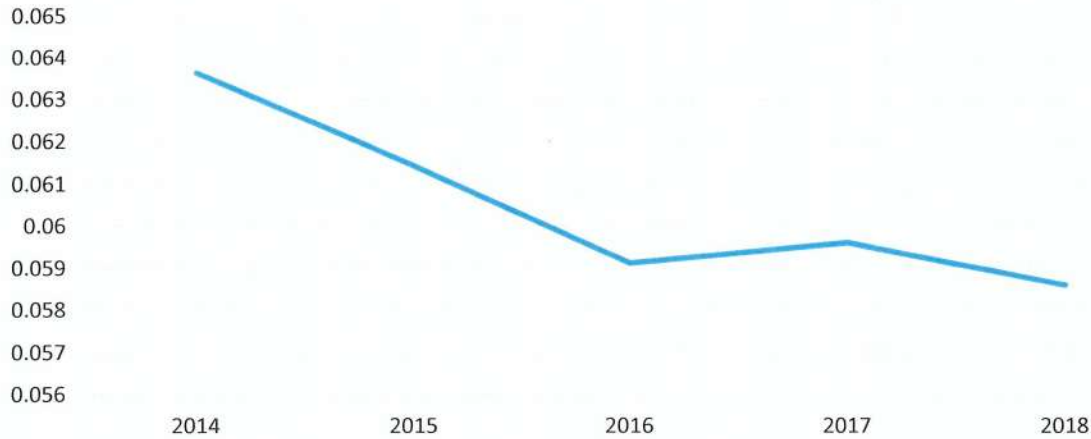
The City's Financial Sustainability Policy provides direction for debt management to maintain a constant threshold of debt service charges, which include external debt service costs and internal transfers to the Debt Reduction Reserve, at a conservative ratio of total debt services charges to taxation revenue well below the legislated allowable maximum. The buffer of transfers to reserves allows for debt service costs to fluctuate without having an impact on property taxes, and enables reserves to be built to allow internal borrowing as a lower cost alternative to external borrowing, both indicators of strength of flexibility.

Figure 4. Total Debt Service Charges



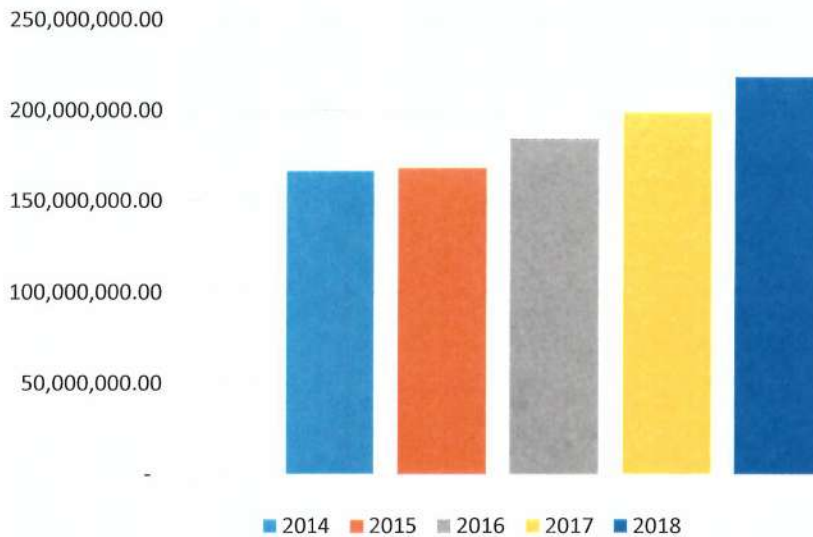
Maintaining the policy threshold level of total debt charges results in a downward trend of the debt charges to taxation revenue indicator, adding further strength to flexibility.

Figure 5. Total Debt Service Charges to Taxation Revenue



The City's Reserve Fund Policy, which was most recently reviewed and updated in 2015, guides the development and use of reserve funds. The City continues to grow reserve balances (Figure 6) in alignment with the City's strategic objectives for services and asset replacement funding requirements. The City does not yet have all master plans in place to determine asset replacement funding needs, however there is sufficient information to identify funding gaps for facilities, fleet and roads. Until complete asset master plans are developed, these gaps are addressed by continuing to grow reserve balances to support strengthening the City's sustainability and flexibility in relation to capital funding decisions.

Figure 6. Reserve Fund Balances

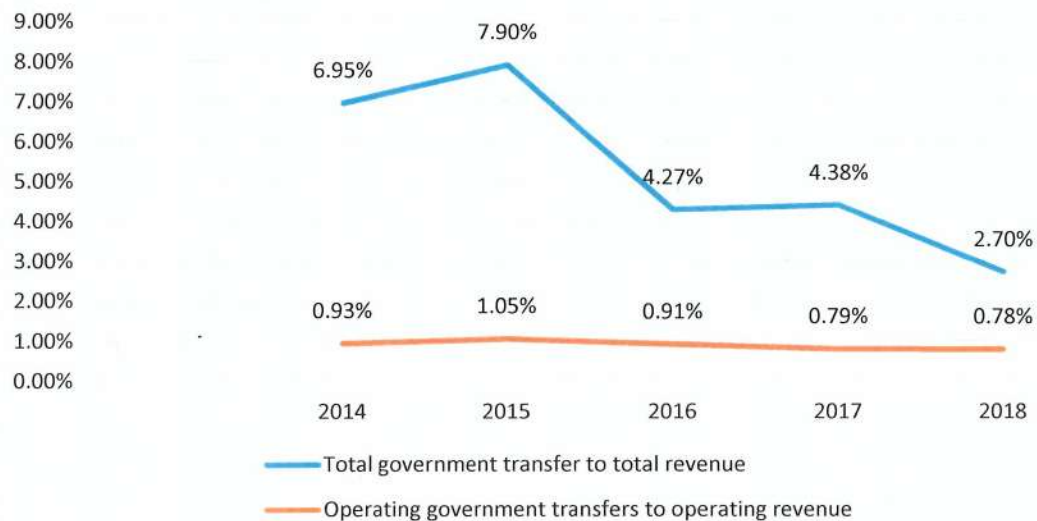


Vulnerability

Vulnerability is the degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations. A government whose vulnerability is relatively low has greater control over its financial condition.

The government transfers to total revenue indicator can provide insight into a government's vulnerability as a result of dependency on another government. The City's ratio of total government transfers to total revenue is at a downward trend, indicating a reduction of vulnerability. This ratio is impacted by large grants received for large capital projects. Considering only the operating government transfers received in relation to total operating revenue, the ratio is significantly lower and continues to trend downward.

Figure 7. Vulnerability Indicators



The City's Financial Sustainability Policy states in its Primary Objective that the "policies shall be designed and structured to develop principles that guide, support, and respect the direction of the community so that tax payers can look forward to stable, equitable and affordable property taxation". The indicators of financial condition illustrate that the application of these principles guide decisions that support building the City's financial strengths in sustainability and flexibility, while considering the risk of vulnerability.

Financial Statement Analysis

Accumulated Surplus

The Accumulated Surplus balance at December 31, 2018, as reported on the Statement of Financial Position, is \$675 million. This is the accumulation of the City's increases in equity in capital assets and reserve balances since its inception. The balance represents the total economic resources available to the City and indicates how much the City's assets exceed its liabilities.

Of the economic resources available, equity in capital assets makes up the most significant portion of the accumulated surplus balance, followed by reserve balances (Figure 2). The current year General Fund Surplus of \$4.554 million makes up a small portion of the Accumulated Surplus balance.

Figure 2. Accumulated Surplus

At December 31, 2018

\$675,279,247

Reserve Balances,
215,119,543

2018 General Fund Surplus,
4,544,049

Equity in Tangible Capital Assets,
455,615,655



This means that the majority of the \$675 million accumulated surplus consists of the City's tangible capital assets, such as roads, underground infrastructure, land, buildings, and equipment, along with funds set aside in reserves for future spending.

Annual Surplus

The annual surplus represents the economic resources gained by the City during the year and is reported on the Statement of Operations. The City's annual surplus for 2018 is \$55 million. Most of this surplus is comprised of increased equity in capital assets and growth in reserve balances (Figure 3). Of the total annual surplus balance, \$4.554 million is the General Fund surplus which is available for future spending.

The primary contributions to the 2018 General Fund surplus of \$4.554 million are higher than expected revenue from parking and the Victoria Conference Centre, as well as expenditures less than budgeted due to staff vacancies and unspent contingency. Council makes a decision annually on the use of the current year General Fund surplus which is incorporated into the following year's budget.

Figure 3. Annual Surplus

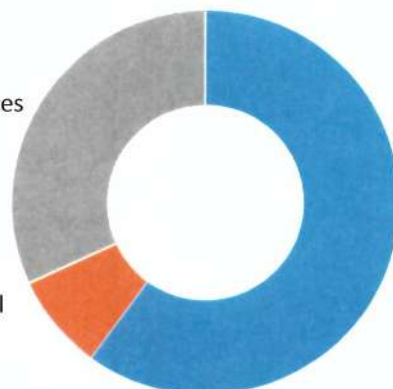
For the year ended December 31, 2018

\$55,356,780

Change in Reserve Balances
17,598,158

2018 General Operating Surplus
4,544,049

Change in Equity in Tangible Capital Assets
33,214,575



Reserves

All of the City reserve funds were established by bylaw under section 188 of the Community Charter. Funding from these reserves can only be used for the specific purposes outlined in the bylaw.

In 2018 the City's reserves grew by \$19.5 million (Table 1). The reserve balance total includes funding for capital projects in progress. Funding is only drawn down from reserves as capital projects are completed; fewer projects than planned were completed by December 31; and some projects experienced schedule adjustments to begin at a later date.

Specific to 2018, Capital projects that are underway include:

- Cecelia Ravine New Park
- Topaz Park – Park Improvement Plan
- Bicycle Master Plan Implementation
- David Foster Harbour Pathway
- Ship Point Pier
- Summit Park – Playground Upgrade
- Gates of Harmonious Interest
- Parkade Repair and Rehabilitation
- Point Ellice Bridge Rehabilitation
- Public Washroom Improvements
- Laurel Point Remediation
- Vehicle and Heavy Equipment Replacement
- Water, sewer, and storm water mains replacement projects

Table 1. Reserve Balances

| Reserve Fund Description | Dec 31, 2017 | Transfer | | Interest | Dec 31, 2018 |
|--|-----------------------|---------------------|------------------------|---------------------|-----------------------|
| | | To | From | | |
| Financial Stability Reserves | \$ 54,794,384 | \$ 4,832,852 | \$ (698,067) | \$ 1,216,434 | \$ 60,145,602 |
| Equipment & Infrastructure Replacement Fund | 131,429,907 | 29,657,678 | (17,208,421) | 2,917,743 | 146,796,907 |
| Tax Sale Lands Fund | 5,789,588 | 50,000 | (1,992,161) | 128,529 | 3,975,956 |
| Parks and Greenways Acquisition Fund | 2,724,295 | 482,608 | (380,465) | 60,479 | 2,886,917 |
| Local Amenities | 754,439 | 194,449 | - | 16,748 | 965,636 |
| Affordable Housing | 1,950,332 | 237,285 | - | 43,298 | 2,230,915 |
| Climate Action | 850,691 | 131,228 | (206,360) | 18,885 | 794,445 |
| Art In Public Places | 596,335 | 135,000 | (277,107) | 13,239 | 467,467 |
| Downtown Core Area Public Realm Improvements | 153,451 | 59,321 | - | 3,407 | 216,180 |
| Heritage Building Seismic Upgrades | 89,112 | 59,321 | - | 1,978 | 150,411 |
| Total Reserve Funds Balance | \$ 199,132,534 | \$35,839,743 | \$ (20,762,581) | \$ 4,420,740 | \$ 218,630,436 |

Development Cost Charges

Development Cost Charges (DCCs) are contributions from developers collected under bylaw to provide funds to assist the City to pay the capital costs of providing, constructing, altering or expanding transportation, water, drainage, and sewage facilities, and of providing and improving parkland related to population growth.

DCC balances (Table 2) increased in 2018 by \$354,619 in interest revenue allocated and \$3.17 million in charges, compared to \$2.47 million in charges collected in 2017. A total of \$114,173 was used to fund capital projects in 2018, compared to \$251,814 funded from the DCC balances in 2017.

A review of DCCs was completed in early 2017, and the City's DCC bylaw and rates were updated in the spring of 2017. At that time, Parks DCC projects and Sewer DCC projects were only partially updated due to the pending completion of the Parks and Open Spaces Master Plan and the update

of the Sewer Master Plan. Council also approved a DCC Policy, which contemplates annual inflationary updates to fees as well as a full review of the Bylaw and fees every five years.

In May 2018 Council approved updated DCC rates for parks and sewage to reflect newly available engineering and planning information, and to combine the Parkland Acquisition Fund and Parkland Development Fund. The amended DCC bylaw was adopted in September 2018.

Table 2. DCC Balances

| Development Cost Charges | Dec 31, 2017 | Transfer | | Interest | Dec 31, 2018 |
|---------------------------------------|---------------------|--------------------|-------------------|------------------|---------------------|
| | | To | From | | |
| Water and Environment | \$ 748,807 | \$ - | \$ 50,115 | \$ 16,624 | \$ 715,316 |
| Transportation | 6,614,538 | 1,121,996 | 38,881 | 146,843 | 7,844,496 |
| Water | 676,461 | 192,460 | - | 15,018 | 883,939 |
| Drainage | 393,136 | 120,500 | - | 8,728 | 522,364 |
| Sewage | 2,720,172 | 545,701 | 25,177 | 60,388 | 3,301,084 |
| Parkland Acquisition and Development | 4,820,647 | 1,193,963 | - | 107,018 | 6,121,628 |
| Total Development Cost Charges | \$15,973,761 | \$3,174,620 | \$ 114,173 | \$354,619 | \$19,388,827 |

Capital Assets

The City's inventory of capital assets (Table 3), cost before accumulated amortization, increased by \$42 million with the most significant increases resulting from:

- \$11.8 million of water/sewer/storm drain infrastructure
- \$ 6.7 million of bridge infrastructure
- \$ 3.8 million of street rehabilitation
- \$ 3.4 million for Douglas Street Bus Lanes
- \$ 2.4 million for vehicle and heavy equipment replacement
- \$ 1.9 million of bicycle master plan implementation
- \$ 1.6 million for Laurel Point remediation

Table 3. Capital Assets

| Capital Assets (Historical Costs) | 2018 | 2017 |
|---------------------------------------|----------------|----------------|
| Land | \$ 138,460,093 | \$ 138,382,972 |
| Buildings | 114,660,197 | 112,096,953 |
| Furniture, Equip, Tech & Vehicles | 79,497,660 | 75,414,390 |
| Roads, Bridges and Highways | 222,495,284 | 109,137,764 |
| Water Infrastructure | 72,927,515 | 68,644,720 |
| Sewer Infrastructure | 28,089,393 | 24,210,056 |
| Drainage Infrastructure | 25,079,575 | 23,725,459 |
| Assets Under Construction | 27,772,870 | 115,308,436 |
| Total Capital Assets | 708,982,587 | 666,920,750 |
| Accumulated Amortization | (183,960,929) | (171,136,014) |
| Total Capital Assets (Net Book Value) | \$ 525,021,658 | \$ 495,784,736 |

Debt

The City's outstanding debt (Table 4) decreased in the year by \$3.98 million. No new debt was issued in 2018.

Debt Management is governed by the City's Financial Sustainability Policy, which directs that debt can only be incurred for one-time capital purchases and not for ongoing capital programs or operational expenses. The philosophy supporting the City's Financial Sustainability Policy and Reserve Fund Policy is to balance the use of debt and reserves for capital funding to recognize the appropriate sharing of funding from current taxpayers as well as future beneficiaries.

Table 4. Debt

| Debt Issues (in millions) | Expiry Date | 2018 | 2017 |
|--|--------------------------|------------------|------------------|
| Issue 79, 80, 81 – Arena | 2033 / 2034 | 20.32 | 21.22 |
| Issue 102 – City Hall Upgrades & Burnside Gorge Community Centre | 2022 | 1.46 | 1.80 |
| Issue 105 – Crystal Gardens | 2024 | 1.58 | 1.82 |
| Issue 103, 105, 110 – Parkades Upgrades | 2023 / 2023 / 2025 | 4.25 | 4.86 |
| Issue 115, 130, 139, 142 – Johnson Street Bridge | 2031 / 2034 / 2036/ 2037 | 41.66 | 43.55 |
| Total Debt | | \$69.27 m | \$73.25 m |

Figure 5. Total Debt Balance over 5 years



Debt service charges (principal repayment, interest costs, and transfer to debt reduction reserve) are directed by the Financial Sustainability Policy to be maintained at a maximum of 7% of the prior year's property tax levy and new debt is added only in the years when other debt issues are retired. The current debt servicing costs (principal repayment and interest) are well below this level, therefore \$3 million is transferred to the Debt Reduction Reserve to be available for internal borrowing as an alternative to incurring external debt. This internal borrowing will allow funding for the replacement of Fire Department Headquarters to occur at a lower interest cost.

Portfolio Investments

The City's investment portfolio (Tables 5 and 6) returned \$5.39 million in 2018, an increase of \$1.95 million over 2017. The actual investment portfolio rate of return was 2.42%:

- 47.5% greater than the return of the MFA money market fund
- 24% greater than the City's average bank account interest rate

The increase in investment revenue over 2017 is due primarily to increased rates of return in the investment market.

The investment portfolio is governed by the City's Investment Policy, which prioritizes the safety of public funds through diversification, provides liquidity to meet cash flow demands, and yields the highest returns within the limits prescribed by Community Charter s.183, Investment of Municipal Funds.

Council has also directed staff to seek out investments that are fossil fuel free and has committed to investing in a new Socially Responsible Investment Fund through the Municipal Finance Authority, should it be created. Currently the market is limited in fossil fuel free investments that the City has the authority to invest in under the Community Charter. However, the largest portion of the City's investments are held with Credit Unions who generally have a philosophy that aligns with that principle. These investments currently also provide competitive yields in the market and therefore align with the City's policy for highest returns.

The majority of investment revenue is allocated to reserves, per the City's Reserve Fund Policy.

Table 5. Investment Portfolio

| Investment Portfolio | Share | 2018 | | 2017 | |
|--|-------|----------------|-------|----------------|-------|
| | | Value | Share | Value | Share |
| MFA Pooled Investments (Cash and Cash Equiv) | 30% | \$ 73,532,054 | 31% | \$ 69,527,783 | |
| Schedule 1 Banks | 21% | 51,000,000 | 23% | 50,900,000 | |
| Credit Unions | 49% | 120,000,000 | 46% | 102,000,000 | |
| | 100% | \$ 244,532,054 | 100% | \$ 222,427,783 | |

Table 6. Investment Returns

| Investment Returns | 2018 | 2017 |
|----------------------------|--------------|--------------|
| Investment Returns | \$ 5,392,768 | \$ 3,433,384 |
| Actual Rate of Return | 2.42% | 1.60% |
| MFA Money Market Return | 1.64% | 0.98% |
| Average Bank Interest Rate | 1.95% | 1.20% |

Figure 7. Rate of Return on Portfolio Investments over 5 years



Revenues and Expenses

The Financial Statements are presented in accordance with PSAB reporting standards to ensure comparability between government organizations across Canada. The budget information in the Statement of Operations was developed for the purpose of the Financial Plan, which is customized to the operations of individual government organizations. The format of the financial statements does not provide an effective comparison of budget to actual performance as the budget process does not take into account adjustments made for PSAB reporting standards.

In order to provide a meaningful comparison of budget to actual performance, additional schedules are attached to this report providing 2018 comparison of budget to actual for operating revenues and expenses (Appendix C), and capital expenditures (Appendix D). These comparisons are provided in the format for budget reporting for the year.

Information Presentation

Recently Council passed a motion to improve governance and transparency. This report speaks to two of the best practices identified in the motion:

- Publish information on Council member expense on a quarterly basis
- Provide clear and accessible summaries of financial information in the municipality's Annual Report and in annual financial planning documents

The City's quarterly reporting has been updated and will include information on Council member expenses, beginning with 2019 Q1.

The City continues to fulfill statutory obligations to provide an Annual Report and Audited Financial Statements that meet the requirements of the Community Charter. Specific to the motion, the annual report provides an annual summary of the quarterly progress reports and provides key highlights and performance measures in visual graphics so that it is easily understood. The annual financial planning documents includes an in-depth detailed plan as well as short versions of the budget and financial information highlights.

CONCLUSION

BDO conducted the City's 2018 audit and have stated in the Auditor's Report their opinion is that these financial statements present fairly, in all material respects, the City's financial position as of December 31, 2018, and its results of operations and changes in net financial assets and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Respectfully submitted,



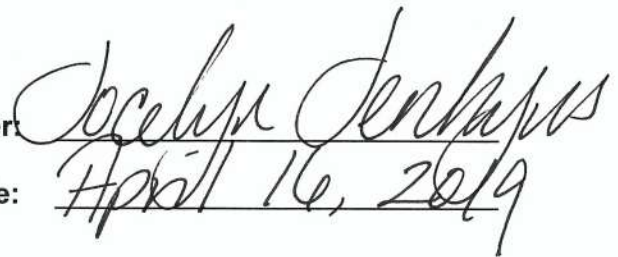
Laurel Westinghouse
Manager, Accounting



Susanne Thompson
Deputy City Manager/CFO

Report accepted and recommended by the City Manager

Date:


April 16, 2019

List of Appendices

- Appendix A – Draft Audited Financial Statements for the year ended December 31, 2018
- Appendix B – Audit Findings Report
- Appendix C – Budget to Actual Operating Revenues and Expenses
- Appendix D – Budget to Actual Capital Expenditures