

Municipality of Chatham-Kent

Finance, Budget, Information Technology & Transformation

Financial Services

To: Mayor and Members of Council

From: Matt Torrance, MBA, CPA, CGA
Director, Financial Services

Date: September 13, 2022

Subject: 2021 Audited Financial Statements

Recommendation

It is recommended that:

1. The audited financial statements for the year ended December 31, 2021 be approved.

Background

Under section 286 of the Municipal Act, 2001, Finance is responsible for payments and collections, for record keeping, for investments and for providing Council with financial information. All financial statements are prepared by Municipal staff. The Auditor reviews these statements to ensure compliance with legislation, regulations and accounting standards.

Since its inception, the Municipality of Chatham-Kent has had its financial records and its financial control systems audited annually by an independent firm of external auditors appointed under contract by Council. The senior audit partner provides the opportunity to meet directly with the Audit Policy Committee in closed session at least annually, with Municipal staff absent, to obtain comments and instructions. In addition to the standard audit report, the auditor conducts extra tests and examinations based on the Audit Policy Committee's concerns. Results of the audit are shared directly with the Audit Policy Committee and ultimately the statements are approved by Council in this report.

As well as investigating specific Council concerns, the external auditors' objectives are to:

- Obtain assurance that the financial statements are free of material misstatement
- Evaluate the fairness of presentation of the financial statements in accordance with local government accounting standards established by the Public Sector Accounting Board (PSAB) and the Chartered Professional Accountants of Canada (CPA Canada).

- Report to administration and to Council on:
 - significant internal control weaknesses
 - errors noted during the audit
 - any matters the auditor believes should be disclosed

Other statutory financial audits that can occur include:

- Canada Revenue Agency (CRA) audits of employer statutory remittances
- CRA audits of HST returns
- Ministry Program specific audits

The Municipality also engages HST/Retail Sales tax specialists for non-statutory audits to ensure the proper amount of federal and provincial sales tax is charged or claimed.

Copies of the draft audited financial statements are attached as Appendix A and a final signed version will be presented on the municipal website once approved by Council. A synopsis of the financial results will be published in local papers following acceptance of this report (section 295.1, Municipal Act).

Financial statement information is prepared using information from the Financial Information Return (FIR) which is a statutory report filed with the Ministry of Municipal Affairs and Housing annually. Copies of the FIR and financial statements are available on request, free of charge (section 295.2, Municipal Act).

Comments

The external auditor has concluded a review of the records of the Corporation and has issued an unqualified audit opinion on the basis of this review. This means that there were no significant internal financial control weaknesses or material errors noted during the audit.

Audit Policy Committee

The Audit Policy Committee met on September 19, 2022 with the Audit Partner from Deloitte and received the Year-End Communication Report detailing their findings. The committee reviewed the financial statements in detail and the minutes of the meeting are included in the Consent Agenda of the September 26 Council meeting. The committee passed the following motion:

That the Audit Policy Committee receive the 2021 Audited Financial Statements and recommend the approval of the statements to Council.

Reported 2021 results

The following are additional comments regarding the financial statements.

This excerpt from the Consolidated Statement of Operations and Accumulated Surplus (see page 4 of the attached financial statement) lists the total revenues, expenses, and the resulting excess revenues over expenses.

	2021	2020
Revenues	\$429,482,361	\$386,015,889
Expenses	\$357,155,080	\$337,560,079
Excess revenues over expenses before other items	\$72,327,281	\$48,455,810
Income from subsidiary	\$4,757,026	\$4,994,126
Excess revenues over expenses	\$77,084,307	\$53,449,936

The Municipal 2021 year-end cash basis surplus is \$290,216 (\$3,767,954 in 2020). Budget and Performance Services will provide in a separate 2021 final variance report where the surplus originated and recommendations on its use. This figure is included as part of the \$77,084,307 (\$53,449,936 in 2020) excess revenue over expenses reported on the Consolidated Statement of Operations and Accumulated Surplus. The \$77 million surplus (under the new accounting rules introduced in 2009) is calculated using accrual accounting, whereas the balanced budget is approved by Council on the cash required basis. Previous to 2009, under modified cash accounting, investments in bridges and roads etc. were written off immediately against in-year surpluses. Under accrual accounting, the cost of capital assets is to be written off against tax revenues over the useful life of the asset. Some of the assets have a useful life of 50+ years. This results in amortization expense much less than expensed over the cash requirements for replacement. For this reason there will usually be an annual surplus in the operating statement. The following table indicates the relation between the \$77 million accrual accounting surplus in the financial statements to the \$290,216 surplus as per the balanced cash budget approved by Council during the 2021 budget deliberations.

	2021	2020
Accrual basis surplus as per Financial Statements	\$77,084,307	\$53,449,936
Adjustments:		
Amortization	\$42,588,145	\$43,032,474
Taxation, Grant, & Other	(\$79,824,457)	(\$33,564,428)
Long-term debt repayment	(\$9,167,981)	(\$9,577,435)
Income from subsidiary	(\$4,757,026)	(\$4,994,126)
Change in employee future benefits	\$3,202,211	\$2,368,956
Acquisition of tangible capital assets	(\$37,119,263)	(\$42,296,189)
Gain on sale of tangible capital assets	\$100,138	\$1,563,330
Proceeds on sale of tangible capital assets	\$434,329	\$531,794
Change in WIP tangible capital assets	(\$26,932,960)	(\$10,101,829)
Change in working capital	\$34,743,036	\$3,415,002
Change in interest accrual on LTD	(\$60,263)	(\$59,530)
Cash basis surplus as previously reported to Council	\$290,216	\$3,767,954

The attached consolidated municipal financial statements include the PUC (Water/Wastewater), the Library, Museums, Board of Health and Police Services Board, along with all other municipal services. Separate audits for the Public Health Division, Library and Children's Services programs were also prepared as required for their specific reporting purposes and are available upon request. One-time special audits are done as required for grant or loan purposes. Municipal trust activities are audited separately. Entegrus Inc. financial results are reflected in separate audited statements.

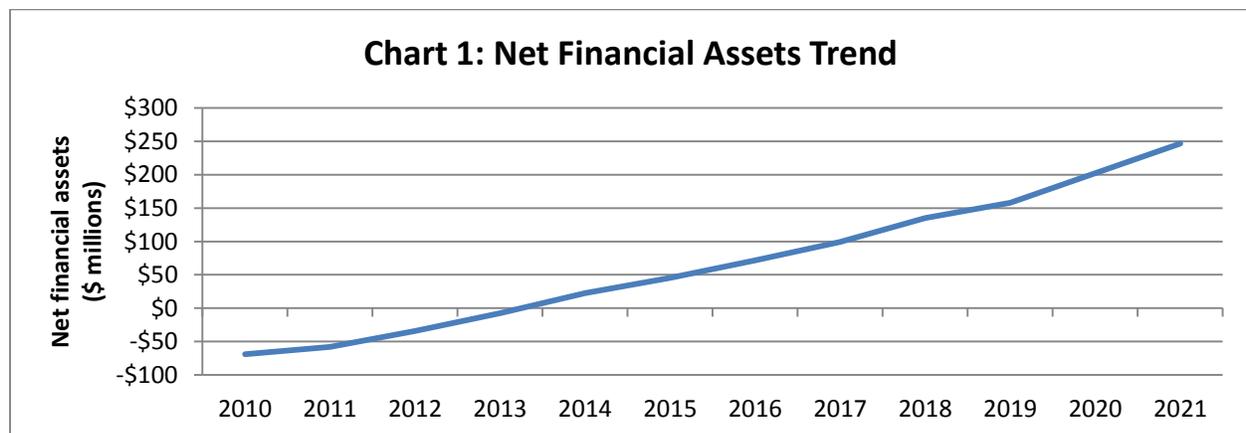
The 2021 net income of these operations is reported on the Statement of Operations as “Income from Subsidiaries”. The accumulated investment in this operation is reported as “Investment in Entegrus Inc.” on the Statement of Financial Position.

The following excerpt from the Consolidated Statement of Financial Position (see page 3 of the attached financial statement) lists the total assets, liabilities, and the resulting accumulated surplus.

	2021	2020
Financial assets	\$445,452,280	\$401,783,891
Liabilities	<u>\$198,663,798</u>	<u>\$199,199,820</u>
Net financial assets	\$246,788,482	\$202,584,071
Non-financial assets	<u>\$933,711,325</u>	<u>\$900,831,429</u>
Accumulated surplus	\$1,180,499,807	\$1,103,415,500

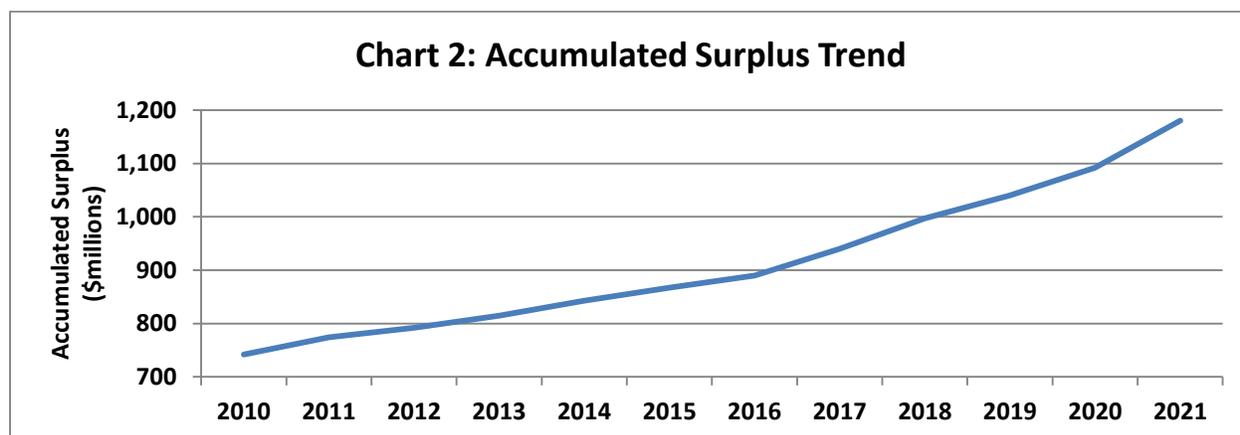
Net Financial Assets

An important indicator of a government’s financial position is its net financial assets, calculated as the difference between its liabilities and financial assets. Net financial assets provides a measure of the future revenues required to pay for past transactions and events. The net financial assets condition of the Municipality has been steadily improving over the past few years as indicated in Chart 1 below, as it has risen from the low of a \$69 million net debt position in 2010 to a positive net financial assets position of \$246 million in 2021.



Accumulated Surplus

Accumulated Surplus includes Net Financial Assets (Debt) plus Non-Financial Assets such as capital assets, inventory and prepaid expenses. Chatham-Kent’s Accumulated Surplus at December 31, 2021 was \$1,180,499,807. The accumulated surplus is the primary indicator of resources available to the Municipality to provide future services. This figure consists of the net investments in tangible capital assets, the investment in Entegrus Inc., accumulated fund balances, and reserves, less amounts to be recovered in the future. Note 12 (see page 19 of the attached financial statement) lists the various allocations of surplus. Chart 2 below indicates the trend in the accumulated surplus.



Some of the significant items included in the accumulated surplus are detailed below.

Invested in tangible capital assets is the net investment in tangible capital assets of the Municipality less any outstanding debt related to this investment. The following excerpt from Note 11 (see page 18 of the attached financial statement) lists the net book value of Chatham-Kent's assets.

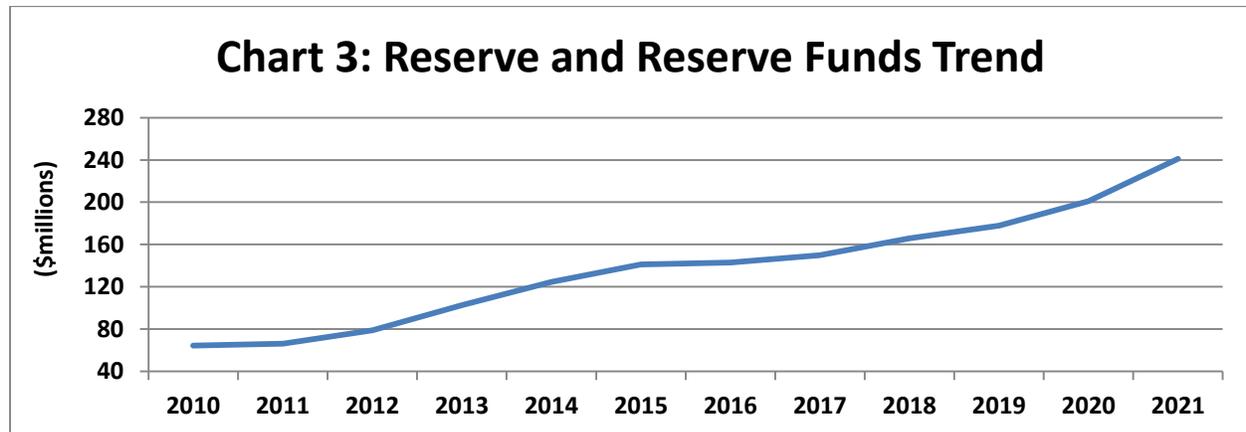
	2021	2020
Land and land improvements	\$52,869,972	\$51,359,492
Buildings	\$111,104,168	\$115,143,640
Equipment	\$44,588,437	\$44,352,753
Vehicles	\$36,632,334	\$35,056,201
Underground Linear	\$223,608,297	\$212,521,302
Plants and facilities	\$34,954,613	\$34,290,384
Bridges	\$159,003,203	\$161,313,530
Transportation	\$195,292,356	\$193,756,183
Other assets	\$1,929,847	\$1,957,838
	<u>\$859,983,227</u>	<u>\$854,231,293</u>
Assets under construction	<u>\$73,181,867</u>	<u>\$46,248,910</u>
Total tangible capital assets	\$933,165,094	\$900,480,203

Entegrus Inc., net equity is represented by the Municipality's share of Retained Earnings plus the value of the shares and long-term note payable to the Municipality for consideration of the original transfer of net assets to Entegrus¹.

¹ The value placed on Entegrus securities is based on cost and may not reflect market values.

	2021	2020
Service Revenue	\$173,965,349	\$190,308,740
Cost of Power	\$149,611,974	\$164,686,359
Gross Margin	\$24,353,375	\$25,622,381
Operating Income	\$29,892,385	\$31,246,803
Net Earnings (100%)	\$9,076,295	\$4,058,694
Retained Earnings (End of Year)	\$31,733,778	\$30,879,989
Dividends Paid to C-K	\$4,146,622	\$4,146,622
Dividends Paid to Corix Utilities	\$460,345	\$460,345
Dividends Paid to St. Thomas Energy	\$1,193,032	\$1,193,032

Reserves and Reserve Funds are the reserve balances at year-end. Chart 3 below indicates the trend with total Reserves and Reserve Funds. See Appendix B for a more detailed breakdown. Reserve balances include amounts encumbered.



Unfunded are for items that are not required to be funded by current accounting regulations, but represent a future cost to the Municipality that financial statement readers should be aware of, and are required to be reported by PSAB regulations. The required disclosures include:

- Post-employment benefits such as life insurance and medical benefits that will be incurred and will potentially be due at some future time. The discount rate used by the actuarial consultant in determining the net present value of future benefits was 2.75% (2.25% in 2020)
- Estimated future liabilities as provided by Workplace Safety & Insurance Board
- Staff vacation credits that have been earned but not taken at year-end
- Interest on long-term debt accrued but not paid by year-end

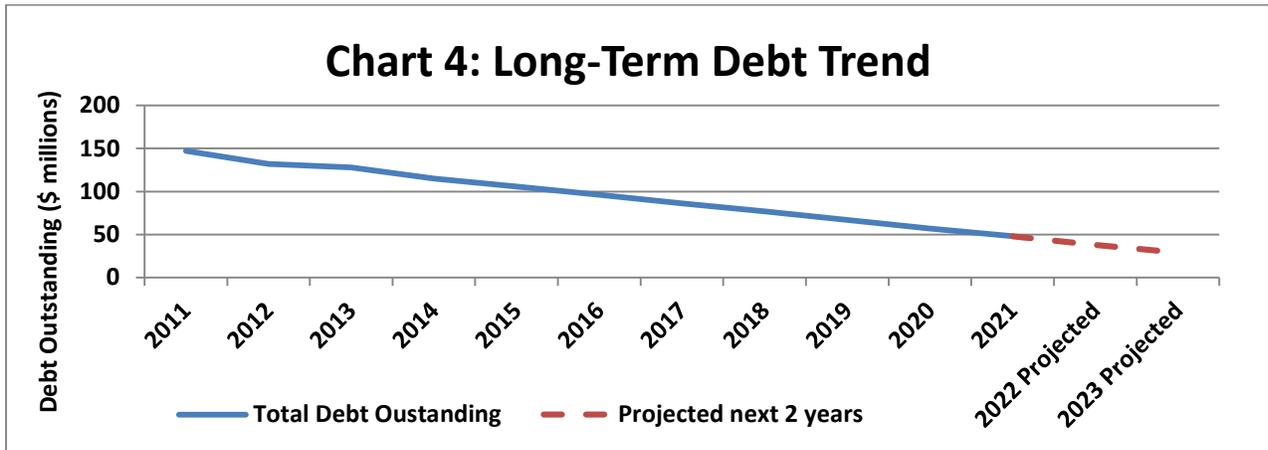
A detailed breakdown of these future obligations to be funded by tax dollars is found below:

	2021	2020
Employee future benefits	\$45,305,505	\$42,258,312
WSIB obligation	\$1,343,667	\$1,343,667
Vacation pay	\$4,780,050	\$4,625,032
Total unfunded employee future benefits	\$51,429,222	\$48,227,011
Interest on long-term liabilities	\$323,781	\$384,044

The Municipality provides funding for these liabilities through the budget process in the year of disbursement.

Long Term Liabilities

Net long-term liabilities are the balances of debentures outstanding. Notes 8 and 9 (see pages 15 and 16 of the financial statement attachment) provide details of the long-term liabilities. The debt trend is indicated in Chart 4 below, and as Council has not approved any current or future projects with debt funding, two further years of reductions are indicated.



The debenture detail is provided in Figure 1 below. There was no new debt issued in 2021 (\$0 in 2021). The “Funded By” columns identify the sources of future funding to service the debt payments. The tax funded obligation is currently approximately \$8.9 million.

Figure 1 Chatham-Kent Long Term Debt as at December 31, 2021								
				Funded by:				
Debt Issue #	Rate %	Term	Total		PUC rates	PUC locals	Mun. Tax	Mun. Other
Debt Issued by the Municipality of Chatham-Kent								
2004-02	2.73	20	43,400,000	(A)	43,400,000			
2005-01	4.94	20	43,000,000	(B)			13,299,000	29,701,000
2005-02	2.53	20	22,128,742	(C)	22,128,742			
2007-01	2.52	20	2,800,000	(D)	2,800,000			
2007-02	4.94	20	5,170,000	(E)				5,170,000
2010-01	4.22	10	12,533,100	(F)			12,533,100	
2010-02	4.88	20	24,244,728	(G)	24,244,728			
2010-03	2	20	2,000,000	(H)	2,000,000			
2013-01	3.91	20	7,978,000	(I)			7,978,000	
Subtotal			163,254,570		94,573,470	0	33,810,100	34,871,000
Less Principal amounts repaid by								
	31-Dec-21		-116,268,851		-66,027,915	0	-24,958,804	-25,282,132
Chatham-Kent Issued Debt Outstanding at Dec 31, 2021			\$46,985,719		\$28,545,555	\$0	\$8,851,296	\$9,588,868
Other Debt assumed by Chatham-Kent								
Social Housing download								
31-Dec-21	Various	Various	924,256	(J)				924,256
Total Debt Outstanding Dec 31, 2021			\$47,909,975		\$28,545,555	\$0	\$8,851,296	\$10,513,124

(A) OMEIFA Debenture: Water \$17,725,000, Wastewater \$25,675,000

(B) OSIFA Debenture: Riverview Gardens \$40,300,000 33% tax funded, Bloomfield Business Park \$2,700,000

(C) OMEIFA Debenture: Water \$19,253,236, Wastewater \$2,875,506

(D) OMEIFA Debenture: Wastewater \$2,800,000

(E) OSIFA Debenture: Social Housing – Wallaceburg Housing Corporation purchase \$5,170,000

(F) OSIFA Debenture: Bridges \$10,533,100, Lifecycle Roads \$1,700,000, Lifecycle Buildings \$300,000

(G) OSIFA Debenture: Water \$9,200,151, Wastewater 15,044,577

(H) Federation of Canadian Municipalities Debenture \$2,000,000

(I) OILC Debenture: John D. Bradley Convention Centre \$7,645,000, Social Housing - Riverview Terrace \$333,000

(J) Debt came with the Social Housing units on transfer to the Municipality from the Province in 2001.

A component of social housing costs are tax funded. The debt is held by Provincial agencies.

Development Charges Act

Under section 43 of the Development Charges Act, 1997, the Treasurer is required to give Council a statement of activity for the Development Charges Reserve Fund. Figure 2 below is a summary of the fund activity.

Figure 2 Development Charges Reserve Fund						
	2021			2020		
	Roads	Water	Sewer	Roads	Water	Sewer
Opening Balance	\$0	\$0	\$0	\$0	\$0	\$0
Contribution from developers	\$0	\$1,981,210	\$1,183,890	\$0	\$1,014,335	\$660,980
Interest Earned	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
	\$0	\$1,981,210	\$1,183,890	\$0	\$1,014,335	\$660,980
Use of funds:						
Investment in Capital	<u>\$0</u>	<u>\$1,981,210</u>	<u>\$1,183,890</u>	<u>\$0</u>	<u>\$1,014,335</u>	<u>\$660,980</u>
Ending Balance	\$0	\$0	\$0	\$0	\$0	\$0

Budget Figures

Budget figures provided as part of the Consolidated Statement of Operations and Accumulated Surplus (see page 4 of the financial statement attachment) do not reflect the balanced 2021 Budget as approved by Council for the following reasons:

- Capital projects benefiting and assessed to landowners and developers, such as water, wastewater, drainage and sidewalks / curb and gutters are not part of the annual budget process and are shown as a local improvement receivable on the Statement of Financial Position
- Capital projects for industrial lands are not part of the budget process and are shown as land held for resale in the Statement of Financial Position
- Under PSAB standards, transfers to/from reserves/capital are not considered as a source of expense/revenue for Municipal activities and are not included in the financial statement budget
- Amortization expense is not included in the Council approved budget as it does not require cash, but is included on the financial statement budget
- Cash raised for the purpose of building or improving tangible capital assets is included as revenue in the Council approved budget and the expenditure of building the asset is included as well. However, in the financial statements, only the revenue budgets (taxes, user fees, grants) are included as the expenditure is an asset amortized over the life of the asset.

Public Utilities Commission

PUC operations are integrated into those of the Municipality. Its activities are audited along with municipal operations. Separate financial statements are prepared and

presented annually to the Commission. A summary cash basis statement for 2021 is presented below along with the 2020 comparison.

As at December 31	Water		Wastewater	
	2021	2020	2021	2020
Revenues	\$31,927,680	\$30,079,813	\$23,551,947	\$22,723,991
Expenditures	<u>\$27,366,635</u>	<u>\$26,131,782</u>	<u>\$21,335,753</u>	<u>\$20,347,349</u>
Net Income	\$4,561,045	\$3,948,031	\$2,216,194	\$2,376,642
Reserve Fund Balance (End of Year)	<u>\$10,194,308</u>	<u>\$1,908,815</u>	<u>\$17,799,966</u>	<u>\$13,700,890</u>

Municipal Leasing

Under regulation 266/02 of the Municipal Act, Council established a financial leasing policy by which the Treasurer shall report annually to Council the impact on municipal finances of financial leases.

Financial leases are a form of indebtedness that if material, can impact on the municipal annual debt repayment limit.

Under the leasing policy:

Section 1. Any lease or cumulative group of leases that exceeds a term of one year that is entered into by the Municipality, being in effect at any one time, shall be considered material if collectively all leasing payments incurred in any calendar year exceeds 2% of the Municipal Annual Debt Repayment Limit as determined by the Treasurer.

Once the 2% limit has been exceeded all leases subsequently entered into by the Municipality shall be considered material.

Section 3. Leasing done for any of the following reasons with a lease term exceeding, or expected to exceed, one year shall be considered a "reportable" lease for the purpose of this policy:

- Capital items leased as a form of financing
- Like equipment with a leased value exceeding \$10,000 annually
- Goods or services only available through lease where collectively lease payments exceed \$20,000 annually
- Leases entered into following a buy versus lease analysis for any property and for any amount

Where, in the opinion of the Treasurer, a lease meets the criteria under this policy as "reportable" or, where the Chief Legal Officer considers a lease reportable for any other reason, Council reports which deal with leasing shall be reviewed and commented on,

in the body of the report, by the Treasurer and (as appropriate) by the Chief Legal Officer.

<u>Materiality Calculations</u>	
Annual Debt Limit (December 31, 2021)	² \$50,814,825
2% of this limit (established by policy)	\$1,016,297
Financial Lease Payments 2021	
Fleet	\$312,345
Copiers	\$194,625
Total	\$506,970

The Municipality does not often use financial leases, as the cost of other forms of indebtedness is more advantageous. Because 2021 financial lease payments are less than 2% of the annual repayment limit established by the Province under regulation 403/02, the value of the leases is not considered material under the financial leasing policy and therefore, will not be deducted from the municipal annual repayment limit for 2021.

Areas of Strategic Focus and Critical Success Factors

The recommendation in this report supports the following areas of strategic focus:

- Economic Prosperity:
Chatham-Kent is an innovative and thriving community with a diversified economy
- A Healthy and Safe Community:
Chatham-Kent is a healthy and safe community with sustainable population growth
- People and Culture:
Chatham-Kent is recognized as a culturally vibrant, dynamic, and creative community
- Environmental Sustainability:
Chatham-Kent is a community that is environmentally sustainable and promotes stewardship of our natural resources

² 2019 Annual Debt Limit Calculation (Effective January 1, 2021)

1 Gross Debt Charges		
	Principal	\$10,411,098
	Interest	\$3,047,956
	Subtotal	\$13,459,054
2 OCWA		-
3 Long term commitments		\$135,000
4 Debt Charges for Lease Purchases		-
5 SUBTOTAL DEBT CHARGES		\$13,459,054
6 Debt Charges for Utilities		-
7 Downtown Revitalization Loans		-
8 Tile Drainage & Shoreline Assistance		\$441,707
9 SUBTOTAL TO BE EXCLUDED		-
10 NET DEBT CHARGES		\$13,152,347

11 Total Revenue Fund Revenues	\$383,781,859
13 Drainage/shoreline fees	\$72,487
14 Donated TCA	-
15 Grants from other governments	
Ontario	\$118,288,253
Canada	\$7,092,822
Other Municipalities, other items	\$1,387,821
Total Grants from Governments	\$126,768,896
16 Deferred Revenue Earned (Development Charges)	\$1,054,295
Amounts to be deducted from revenue	\$127,913,171
17 Net Revenue Fund	\$255,868,688
18 25% of net revenue fund	\$63,967,172
19 Annual Repayment Limit	\$50,814,825

At 4% interest, the Municipality has the capacity to borrow an additional \$691 million with repayment amortized over 20 years.

The recommendation in this report supports the following critical success factors:

- Financial Sustainability:
The Corporation of the Municipality of Chatham-Kent is financially sustainable
- Open, Transparent and Effective Governance:
The Corporation of the Municipality of Chatham-Kent is open, transparent and effectively governed with efficient and bold, visionary leadership
- Has the potential to support all areas of strategic focus & critical success factors
- Neutral issues (does not support negatively or positively)

Consultation

Prior to finalization of the published statements, all departments reviewed their respective areas. The external auditor has concluded a review of the records of the Corporation and has issued an unqualified audit opinion on the basis of this review. This means that there were no significant internal financial control weaknesses or material errors noted during the audit. The Audit Policy Committee has reviewed the statements.

Financial Implications

The accumulated Municipal surplus of \$290,216 will be addressed in a separate Budget & Performance Services report to Council. The cost of the external audit is part of the approved annual budget.

The audit is performed annually in accordance with Section 296 of the Municipal Act. As part of this review, the Auditor:

- Reviewed the accounts and transactions of the Municipality and expressed an opinion.
- Performed duties as required under the Municipal Act and as directed by Council.

A new Request for Proposal for Auditing Services was issued in 2018 with Deloitte LLP. being the successful submission for a period covering 2018 to 2022.

Prepared by: Brock Priddle, CPA, CGA, Manager, Corporate Accounting

Reviewed by:

Matt Torrance, MBA, CPA, CGA, Director, Financial Services

Gord Quinton, MBA, CPA, CGA, Chief Financial Officer, Treasurer

Attachments: App A – Consolidated Financial Statements-Municipality of Chatham-Kent
App B – Chatham-Kent Summary of Reserves