

## Key Findings

### E. Financial Sustainability, Flexibility and Vulnerability

In Canada, the development and maintenance of principles for financial reporting fall under the responsibility of the Accounting Standards Oversight Council ('AcSOC'), a volunteer body established by the Canadian Institute of Chartered Accountants in 2000. In this role, AcSOC provides input to and monitors and evaluates the performance of the two boards that are tasked with established accounting standards for the private and public sector:

- The Public Sector Accounting Board ('PSAB') establishes accounting standards for the public sector, which includes municipal governments; and
- The Accounting Standards Board ('AcSB'), which is responsible for the establishment of accounting standards for Canadian entities outside of the public sector.

In May 2009, PSAB released a Statement of Recommended Practice that provided guidance on how public sector bodies should report on indicators of financial condition. As defined in the statement, 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*'. In reporting on financial condition, PSAB also recommended that three factors, at a minimum, need to be considered:

- **Sustainability.** Sustainability is the degree to which the Region can deliver services and meet its financial commitments without increasing its debt or tax burden relative to the economy in which it operates. To the extent that the level of debt or tax burden grows at a rate that exceeds the growth in the Region's assessment base, there is an increased risk that the Region's current spending levels (and by association, its services, service levels and ability to meet creditor obligations) cannot be maintained.
- **Flexibility.** Flexibility reflects the Region's ability to increase its available sources of funding (debt, taxes or user fees) to meet increasing costs. Municipalities with relatively high flexibility have the potential to absorb cost increases without adversely impacting on affordability for local residents and other ratepayers. On the other hand, municipalities with low levels of flexibility have limited options with respect to generating new revenues, requiring an increased focus on expenditure reduction strategies.
- **Vulnerability.** Vulnerability represents the extent to which the Region is dependent on sources of revenues, predominantly grants from senior levels of government, over which it has no discretion or control. The determination of vulnerability considers (i) unconditional operating grants such as OMPF; (ii) conditional operating grants such as Provincial Gas Tax for transit operations; and (iii) capital grant programs. Municipalities with relatively high indicators of vulnerability are at risk of expenditure reductions or taxation and user fee increases in the event that senior levels of funding are reduced. This is particularly relevant for municipalities that are vulnerable with respect to operating grants from senior levels of government, as the Municipal Act does not allow municipalities to issue long-term debt for operating purposes (Section 408(2.1)).

# Key Findings

As a means of reporting the Region's financial condition, we have considered the following financial indicators (\*denotes PSAB recommended financial indicator).

Financial Condition Category	Financial Indicators
Sustainability	<ol style="list-style-type: none"> <li>1. Financial assets to financial liabilities*</li> <li>2. Total reserves and reserve funds per household</li> <li>3. Capital additions as a percentage of amortization expense</li> </ol>
Flexibility	<ol style="list-style-type: none"> <li>4. Residential taxes per household</li> <li>5. Total long-term debt per household</li> <li>6. Residential taxation as a percentage of average household income</li> <li>7. Debt servicing costs (interest and principal) as a percentage of total revenues*</li> <li>8. Net book value of tangible capital assets as a percentage of historical cost of tangible capital assets*</li> </ol>
Vulnerability	<ol style="list-style-type: none"> <li>9. Operating grants as a percentage of total revenues*</li> <li>10. Capital grants as a percentage of total capital expenditures*</li> </ol>

An overview of these financial indicators, including a comparison of the Region's performance and position against selected upper-tier municipalities (Durham, Halton and Waterloo), is included as Appendix C.

As noted on the following pages, the Region's financial indicators compare favourably with the selected peer municipalities. From an overall perspective, we note that:

- The Region has a lower rate of capital investment than the comparator municipalities, which likely translates into a higher infrastructure deficit;
- The Region's level of reserves is towards the lower end of the range, indicating a lower level of financial flexibility;
- The Region's long-term debt and associated debt servicing costs, are towards the upper range of the comparator municipalities; and
- The Region's taxation levels (upper tier only) are the lowest in terms of residential taxation per household and taxation as a percentage of total assessment. From an affordability perspective, residential taxes as a percentage of household income are the second lowest of the four upper tier municipalities included in the analysis.

We suggest that these factors, both individually and collectively, may increase the Region's potential risk with respect to long-term sustainability and flexibility.





## Region of Niagara Service Sustainability Review

# Appendix C Sustainability, Flexibility and Vulnerability Indicators





# Financial Indicators

## FINANCIAL ASSETS TO FINANCIAL LIABILITIES

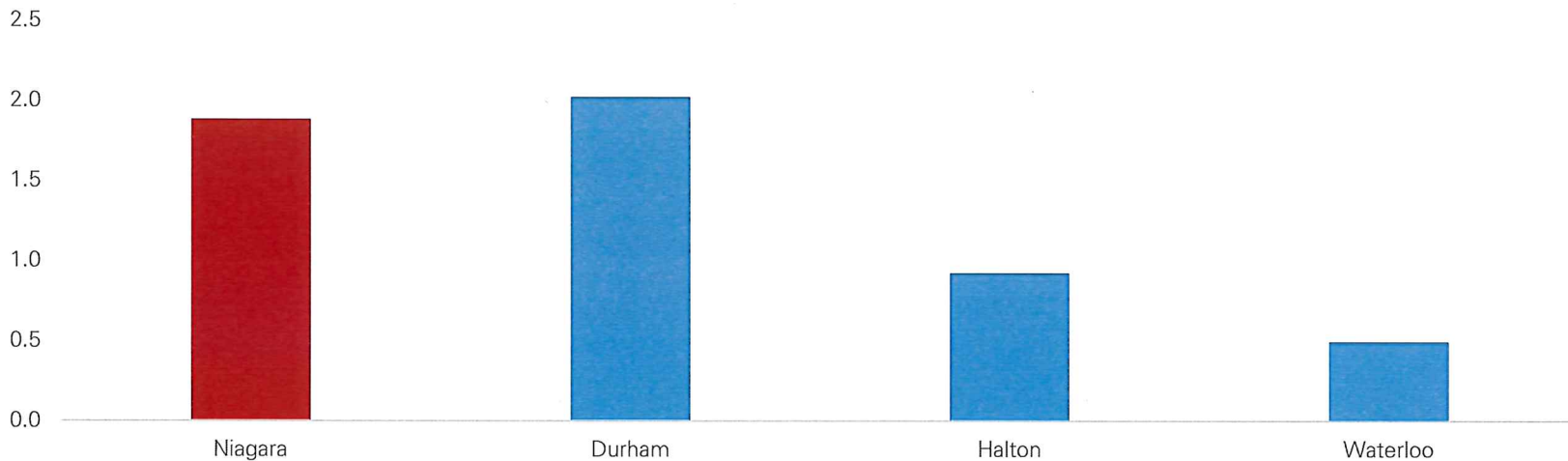
This financial indicator provides an assessment of the Region's solvency by comparing financial assets (including cash, investments and accounts receivable) to financial liabilities (accounts payable, deferred revenue and long-term debt). Lower levels of financial assets to financial liabilities (i.e. less than 1.0) are indicative of limited financial resources available to meet cost increases or revenue losses, which higher levels (i.e. more than 1.5) suggest that the municipality has a higher level of available financial resources to offset cost increases, funding losses or future capital reinvestment.

### TYPE OF INDICATOR

Sustainability ✓  
Flexibility  
Vulnerability

### POTENTIAL LIMITATIONS

- Financial assets may include investments in government business enterprises, which may not necessarily be converted to cash or yield cash dividends
- Financial liabilities may include liabilities for employee future benefits and future landfill closure and post-closure costs, which may (i) not be realized for a number of years; and/or (ii) may not be realized at once but rather over a number of years



# Financial Indicators

## TOTAL RESERVES AND RESERVE FUNDS PER HOUSEHOLD

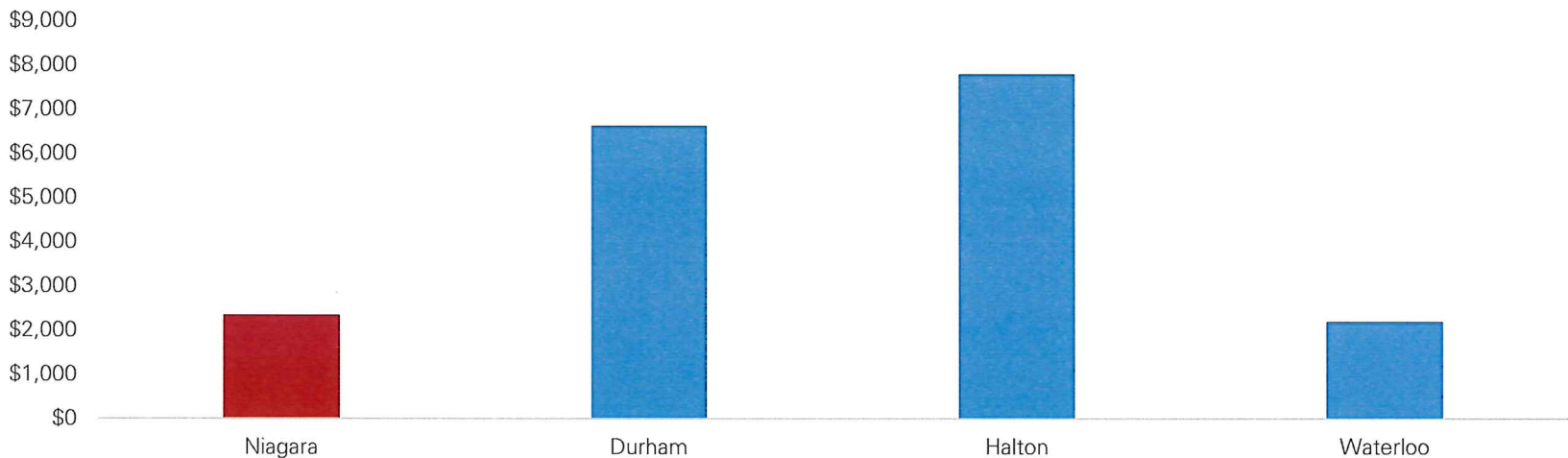
This financial indicator provides an assessment of the Region's ability to absorb incremental expenses or revenue losses through the use of reserves and reserve funds as opposed to taxes, user fees or debt. Low reserve levels are indicative of limited capacity to deal with cost increases or revenue losses, requiring the Region to revert to taxation or user fee increases or the issuance of debt. While there is no defined standard for the "right" level of reserve and reserve funds per household, upper tier municipalities in Ontario reported an average of \$3,800 in reserve and reserve funds per household, which is higher than the Region's reserve and reserve fund balances per household.

### TYPE OF INDICATOR

Sustainability ✓  
Flexibility  
Vulnerability

### POTENTIAL LIMITATIONS

- Reserves and reserve funds are often committed to specific projects or purposes and as such, may not necessarily be available to fund incremental costs or revenue losses
- As reserves are not funded, the Region may not actually have access to financial assets to finance additional expenses or revenue losses



# Financial Indicators

## CAPITAL ADDITIONS AS A PERCENTAGE OF AMORTIZATION EXPENSE

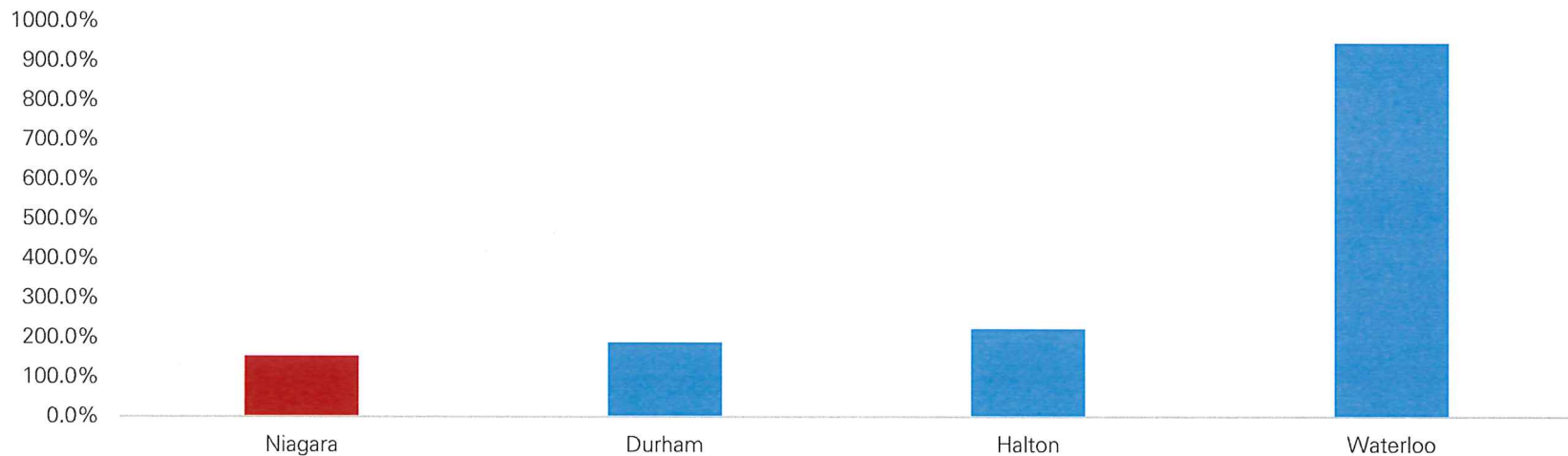
This financial indicator provides an assessment of the Region's solvency by assessing the extent to which it is sustaining its tangible capital assets. In the absence of meaningful reinvestment in tangible capital assets, the Region's ability to continue to deliver services at the current levels may be compromised. Over the long-term, investment levels of less than 100% to 150% can contribute to an increase in a municipality's infrastructure deficit and an associated reduction in service levels, with higher levels of capital investment likely indicative of the sustainment of capital infrastructure.

### TYPE OF INDICATOR

Sustainability ✓  
Flexibility  
Vulnerability

### POTENTIAL LIMITATIONS

- This indicator considers amortization expense, which is based on historical as opposed to replacement cost. As a result, the Region's capital reinvestment requirement will be higher than its reported amortization expense due to the effects of inflation.
- This indicator does not consider the differential between reinvestment of existing infrastructure vs. the construction of new infrastructure as a result of growth, regulatory changes or other factors.



# Financial Indicators

## RESIDENTIAL TAXES PER HOUSEHOLD

This financial indicator provides an assessment of the Region's ability to increase taxes as a means of funding incremental operating and capital expenditures. Determining an appropriate level of taxation per household involves a range of considerations, including services, service levels and the balance between municipal taxation and user fees and as such, there can be considerable variability between municipalities.

### TYPE OF INDICATOR

Sustainability

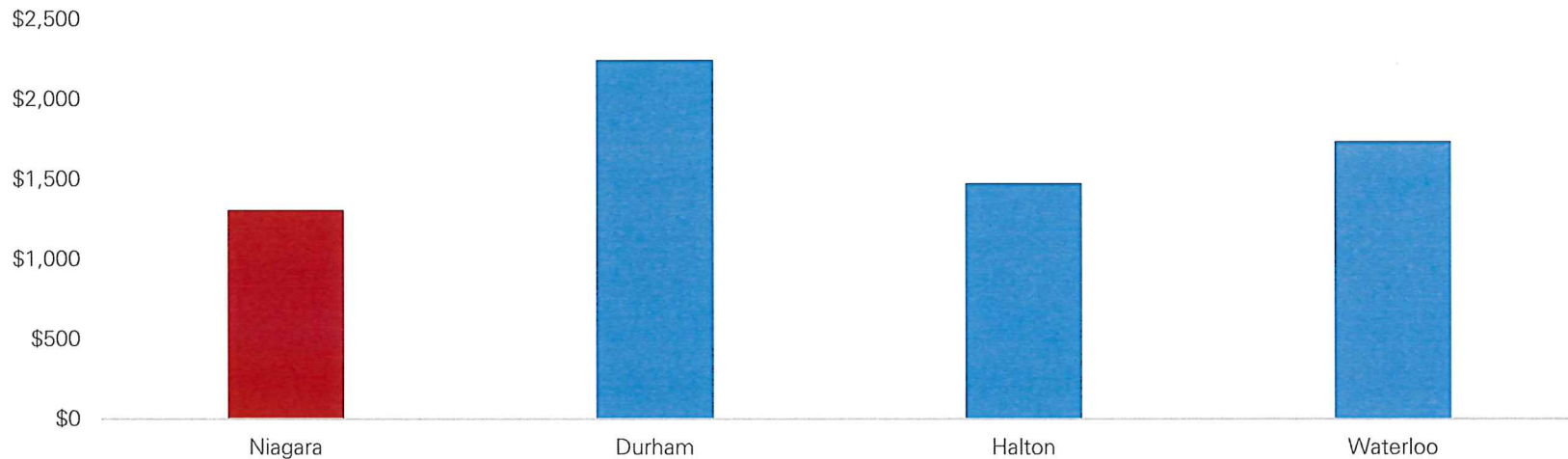
Flexibility

✓

Vulnerability

### POTENTIAL LIMITATIONS

- This indicator does not incorporate income levels for residents and as such, does not fully address affordability concerns.
- In addition to upper tier taxes, taxpayers are also subject to taxation at the lower-tier and education level and as such, this indicator does not reflect the total tax cost to ratepayers.





# Financial Indicators

## TOTAL LONG-TERM DEBT PER HOUSEHOLD

This financial indicator provides an assessment of the Region's ability to issue more debt by considering the existing debt loan on a per household basis. High debt levels per household may preclude the issuance of additional debt or result in a high level of debt servicing costs, while lower levels of debt may be indicative of funded capital requirements. While there is no recommended level of debt for Ontario municipalities (other than the limitation of debt servicing costs), upper tier municipalities in Ontario reported an average of \$3,200 in debt per household, which includes debt issued on behalf of lower tier municipalities.

### TYPE OF INDICATOR

Sustainability

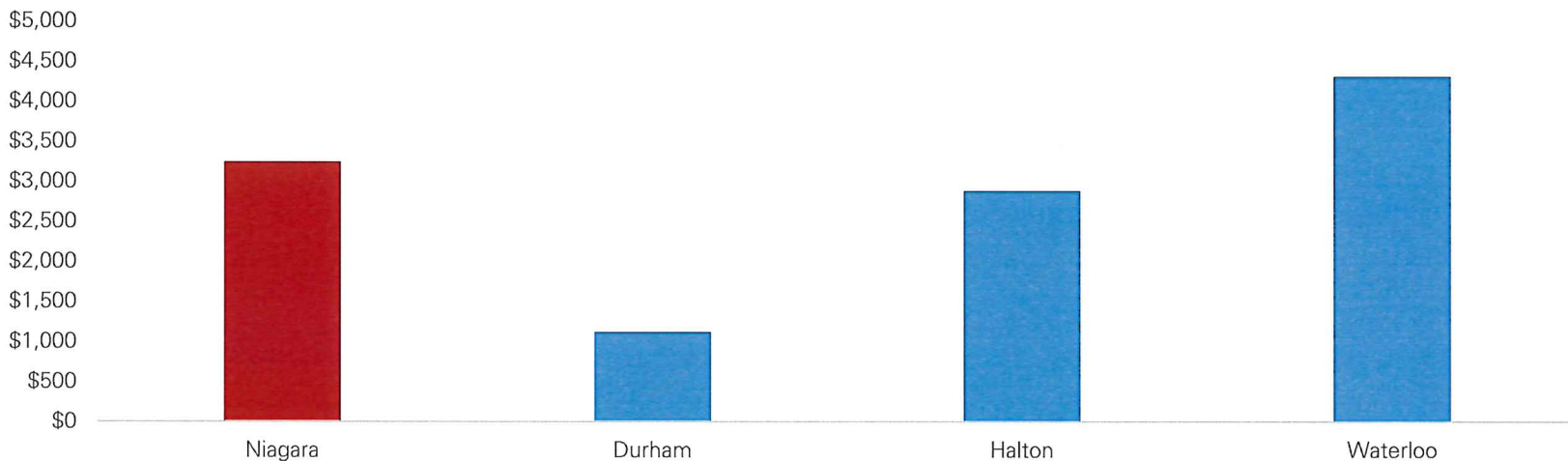
Flexibility

✓

Vulnerability

### POTENTIAL LIMITATIONS

- This indicator does not consider the Provincial limitations on debt servicing cost, which cannot exceed 25% of own-source revenues unless approved by the Ontario Municipal Board





# Financial Indicators

## RESIDENTIAL TAXATION AS A PERCENTAGE OF HOUSEHOLD INCOME

This financial indicator provides an indication of potential affordability concerns by calculating the percentage of total household income used to pay municipal property taxes. Determining an appropriate level of taxation per household involves a range of considerations, including services, service levels and the balance between municipal taxation and user fees and as such, there can be considerable variability between municipalities.

### TYPE OF INDICATOR

Sustainability

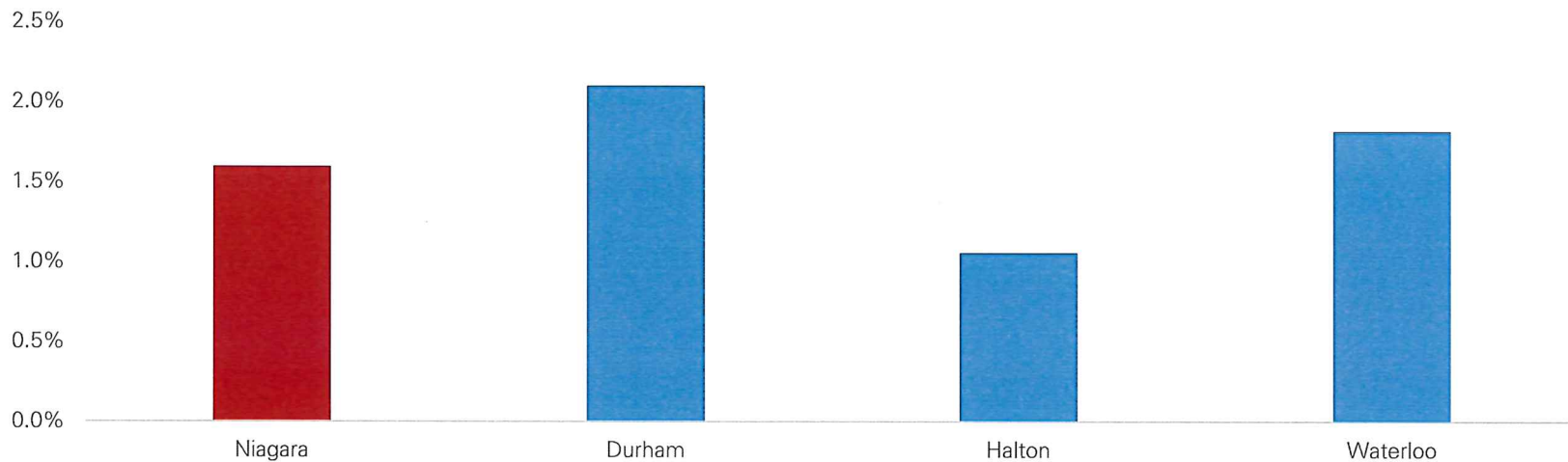
Flexibility



Vulnerability

### POTENTIAL LIMITATIONS

- This indicator considers residential affordability only and does not address commercial or industrial affordability concerns.
- This indicator is calculated on an average household basis and does not provide an indication of affordability concerns for low income or fixed income households.



# Financial Indicators

## DEBT SERVICING COSTS (INTEREST AND PRINCIPAL) AS A PERCENTAGE OF TOTAL REVENUES

This financial indicator provides an indication as to the Region's overall indebtedness by calculating the percentage of revenues used to fund long-term debt servicing costs. High debt levels per household may preclude the issuance of additional debt or result in a high level of debt servicing costs, while lower levels of debt may be indicative of funded capital requirements. While there is no recommended level of debt for Ontario municipalities (other than the limitation of debt servicing costs), upper tier municipalities in Ontario, on average, incurred debt servicing costs (interest and principal) accounting to approximately 4% of total revenues.

### TYPE OF INDICATOR

Sustainability

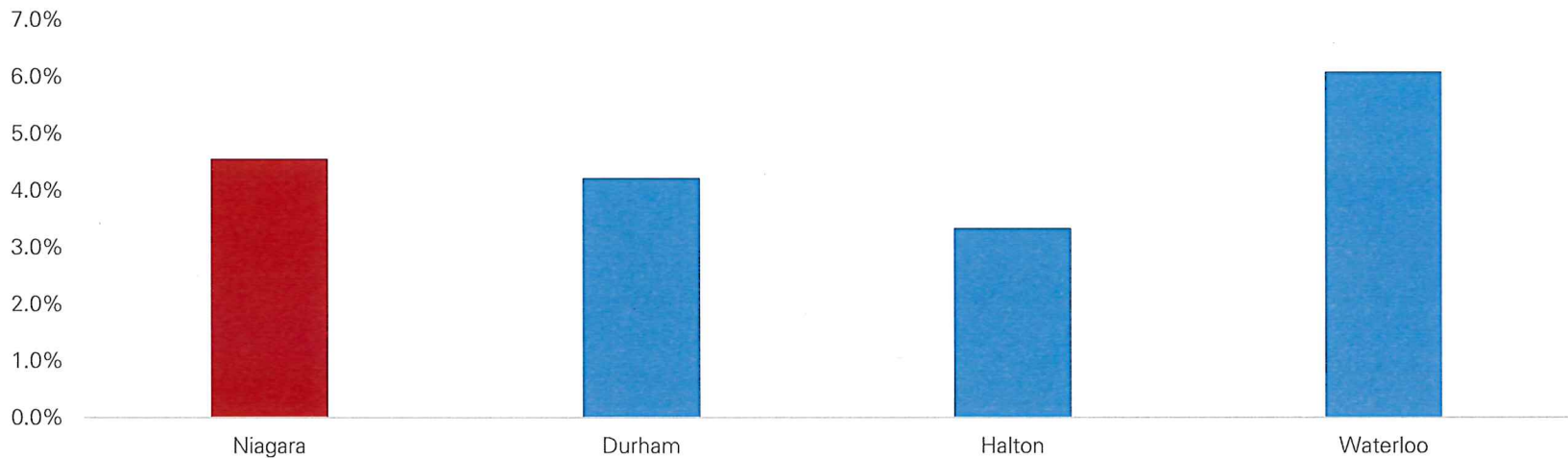
Flexibility



Vulnerability

### POTENTIAL LIMITATIONS

- No significant limitations have been identified in connection with this indicator



# Financial Indicators

## NET BOOK VALUE OF TANGIBLE CAPITAL ASSETS AS A PERCENTAGE OF HISTORICAL COST OF TANGIBLE CAPITAL ASSETS

This financial indicator provides an indication as to the extent to which the Region is reinvesting in its capital assets as they reach the end of their useful lives. An indicator of 50% indicates that the Region is, on average, investing in capital assets as they reach the end of useful life, with indicators of less than 50% indicating that the Region's reinvestment is not keeping pace with the aging of its assets.

### TYPE OF INDICATOR

Sustainability

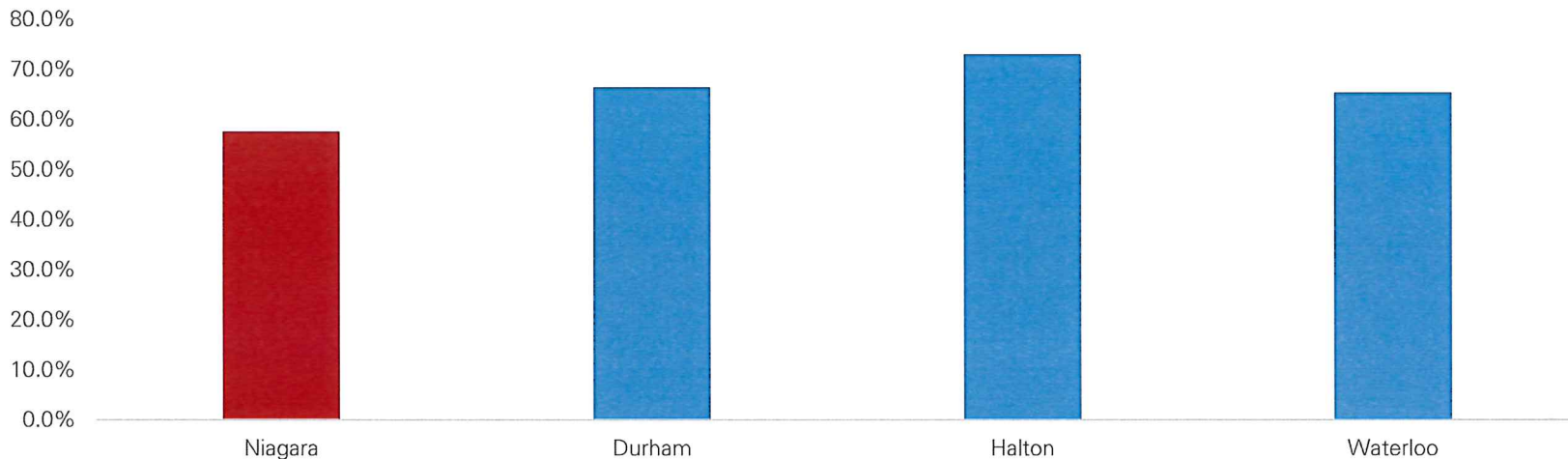
Flexibility



Vulnerability

### POTENTIAL LIMITATIONS

- This indicator is based on the historical cost of the Region's tangible capital assets, as opposed to replacement cost. As a result, the Region's pace of reinvestment is likely lower than calculated by this indicator as replacement cost will exceed historical cost.
- This indicator is calculated on a corporate-level basis and as such, will not identify potential concerns at the departmental level.





# Financial Indicators

## OPERATING GRANTS AS A PERCENTAGE OF TOTAL REVENUES

This financial indicator provides an indication as to the Region's degree of reliance on senior government grants for the purposes of funding operating expenses. The level of operating grants as a percentage of total revenues is directly proportionate with the severity of the impact of a decrease in operating grants. Notwithstanding the increase in a municipality's vulnerability, higher levels of operating grants are sought in order to decrease the share of municipal operating costs funded by taxpayers, decreasing concerns over affordability.

### TYPE OF INDICATOR

Sustainability

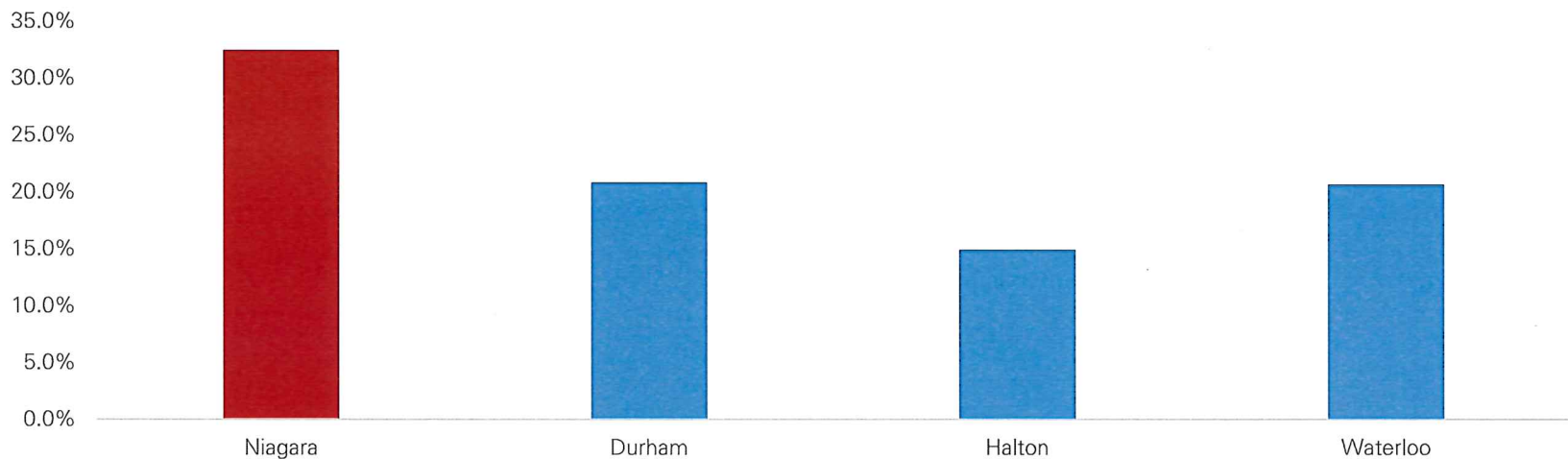
Flexibility

Vulnerability



### POTENTIAL LIMITATIONS

- To the extent possible, the Region should maximize its operating grant revenue. As such, there is arguably no maximum level associated with this financial indicator.



# Financial Indicators

## CAPITAL GRANTS AS A PERCENTAGE OF TOTAL CAPITAL EXPENDITURES

This financial indicator provides an indication as to the Region's degree of reliance on senior government grants for the purposes of funding capital expenditures. The level of capital grants as a percentage of total capital expenditures is directly proportionate with the severity of the impact of a decrease in capital grants. Notwithstanding the increase in a municipality's vulnerability, higher levels of capital grants are sought in order to decrease the share of municipal capital costs funded by taxpayers or debt, decreasing concerns over affordability or borrowing levels.

### TYPE OF INDICATOR

Sustainability

Flexibility

Vulnerability



### POTENTIAL LIMITATIONS

- To the extent possible, the Region should maximize its capital grant revenue. As such, there is arguably no maximum level associated with this financial indicator.

