CANADIAN FINANCE MATTERS

WINTER 2014/15 | VOLUME 15, ISSUE 2

Printable PDF

Committee on Canadian Issues (CCI) Highlights

Minneapolis, MN | Saturday, May 17, 2014

Co-chairs Eric Sawyer and John Martin welcomed the committee to Minneapolis for the thirty-second meeting since the committee's inception in San Francisco in 1998. Rob Bullock, the Executive Director for GFOA of BC, also participated in the meeting.

New GFOA Executive Board Member from Canada

Congratulations to Suzanne Fillion for being elected to the GFOA Executive Board at GFOA's Tuesday business meeting. Suzanne will join John Martin as the two GFOA Executive Board members from Canada. Suzanne succeeds longstanding committee member Eric Sawyer on the Executive Board.

New Committee Members

We would like to welcome the following new committee members: Kevin Bertles, Jackie Dueck, Clae Hack, Rick Masters, and Fuwing Wong. Kevin Bertles is the Director of Financial Services for the City of Vernon; Jackie Dueck is the Systems Reporting Manager for the City of Kelowna; Clae Hack is the Finance Manager for the City of Warman; Rick Masters is the Manager Finance – Transportation, Planning, Development & Assessment for the City of Calgary; and Fuwing Wong is the Chief Financial Officer for the Town of Caledon.

Updates to the committee

Eric Sawyer and John Martin provided an update

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COMMITTEE ON CANADIAN ISSUES (CCI)

Members

Suzanne Fillion, Co-Chair, City of Surrey, BC

John Martin, Co-Chair, City of Moncton, NB

Kevin Bertles, City of Vernon, BC

Carl Bird, City of Yellowknife, NT

Robert Bishop, City of St. John's, NL

Catherine Brubacher, City of Brantford, ON from the GFOA Executive Board and the key activities occurring at GFOA. They noted some of the following items:

- The number of Canadian governments participating in the Canadian Award for Financial Reporting Program and the Budget Awards Program has increased.
- Additional Canadians are attending the conference for the first time by participating in the GFOA scholarship to waive the conference registration for first time attendees.
- Canadian student Daniella Davila Aquije received the GFOA Minorities in Government Finance Scholarship.

Jackie Dueck, City of Kelowna, BC

Cindy Fernandes, City of Winnipeg, MB

Bruce Fisher, Halifax Regional Municipality, NS

Clae Hack, City of Warman, SK

Donna Herridge, City of Mississauga, ON

Patrice Impey, City of Vancouver, BC

Glen Jarbeau, City of Spruce Grove, AB

Greg Kliparchuk, Province of Alberta, AB

Rick Masters, City of Calgary, AB

Tina Tapley, City of Fredericton, NB

Valentina Todoran, Montreal West, QC

Fuwing Wong, Town of Caledon, ON

Committee Advisor

Mark Gilbert, Dalhousie University, Halifax, NS

GFOA Staff Members

Stephen Gauthier, Jim Phillips

Professional Development Task Force
Canadian Session and Canadian Update at the GFOA Annual Conference

Ron Kaufman and Greg Kliparchuk, the co-chairs of the Professional Development Task Force, provided an update on the task force. The major focus of this task force is coordinating the Canadian Session and the Canadian Update at the GFOA annual conference. The committee thanked Greg Kliparchuk for his outstanding effort again this year in recruiting speakers for the Canadian session and the Canadian Update. The Canadian Session covered how finance operations played an integral role in the response to the major flood in Calgary and the ice storms in Ontario. The Canadian Update focused on identifying the competencies required in the finance function of the future. John Fishbein, who coordinates the Budget Program at GFOA, provided practical information on how to prepare a high quality budget.

A survey was distributed to all GFOA members in Canada after this meeting to obtain suggestions from GFOA Canadian members on possible topics and speakers for future Canadian sessions/updates at the GFOA annual conference.

Standards Task Force
Best Practices in Canada

The Standards Task Force coordinates the committee's review of best practices and advisories for their applicability in Canada. The Standards Task Force is led by its co-chair Bruce Fisher. Bruce Fisher discussed a draft of the potential best practice on Tax Increment Financing and Funding as a Fiscal Tool in Canada. The potential best practice will be brought forward for further discussion at the next CCI winter meeting in Canada. The best practices and advisories that have been approved by the committee as applicable in Canada can be viewed in the Canadian Finance section on GFOA's website. Some of the more major best practices have also been translated to French and can be accessed in the Canadian Finance section on GFOA's website.

Advocacy & Communications Task Force
Canadian Newsletter and Provincial Associations Updates

Carl Bird, the co-chair for the Advocacy & Communications Task Force, led the discussion on the task force's recent activities. The major focus for this task force is the GFOA Canadian Newsletter, Canadian Finance Matters. Carl Bird thanked Cindy Fernandes for her outstanding coordination of articles for the spring issue. Cindy Fernandes will be the lead coordinator for the winter issue of the next Canadian newsletter.

GFOA of BC: Rob Bullock, the Executive Director for GFOA of BC, provided an update on the association. In addition updates were provided on the MFOA and the GFOA of Western Canada. The committee discussed the MFOA virtual library. A link for someone to sign up for the MFOA virtual library has been included in the Canadian Finance on GFOA's website.

Discussion on key issues impacting Canadian governments

The committee members discussed how they are best handling key issues that are impacting their government. Among the major topics discussed:

- Infrastructure deficit
- Finding a better way to assign property taxes
- The decrease in the revenue streams
- Making sure that money is available for capital improvements
- Managing the public's expectations when taxes will grow less than inflation
- Balancing the budget when assessment growth is slowing and there are large reductions in provincial grants
- Transition after retirements

New Task Force Co-Chairs

Cindy Fernandes is the new co-chair of the Advocacy & Communications Task Force, Patrice Impey is the new co-chair of the Standards Task Force, and Tina Tapley is the new co-chair of the Professional Development Task Force. The other current task force co-chairs are Carl Bird of the Advocacy & Communications Task Force, Bruce Fisher of the Standards Task Force, and Greg Kliparchuk of the Professional Development Task Force.

Other Business

The committee presented a letter to the President of GFOA, Bob Eichem, thanking him for participating in the Western Canada GFOA conference last year.

Recognition of committee members whose final term is ended

Letters from the CCI were presented to Eric Sawyer, Ron Kaufman and Trevor Bingler thanking them for the outstanding contributions that they made to the committee.

Next meeting

The next meeting will be in the City of St. John's in Newfoundland on Friday, January 30 and Saturday, January 31.

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Highlighted Best Practice

A section of the GFOA website is dedicated to GFOA's best practices that are applicable in Canada. One of the best practices that the Committee on Canadian Issues would like to highlight is Statistical/Supplemental Section of the Budget Document. This best practice recommends how governments can improve the quality of the statistical/supplemental section of their budget documents.

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Towards Structurally Balanced and Sustainable Budgets

Roger Galipeau, Director of CIRANO's Excellence in Budgeting Research Group[1]; rogergalipeau@cirano.qc.ca.
This article was originally published as Chapter 10 of* Le Québec économique 5 (2013-2014) *(Presses de l'Université Laval). This translation is included with permission.

Abstract

This chapter presents an overview of the policies and rules of practice indicative of the new strategies being adopted in Quebec and elsewhere in Canada to reorient and restructure the management of public finances to make them stable, sustainable, predictable and capable of withstanding economic shocks like the one that occurred in 2008. To date, no city in Canada has passed what could be called, strictly speaking, a structurally balanced and sustainable budget, although several have incorporated some components of such a budget into their financial plans and are continuing to add parts in the form of new policies or new rules of practice. The Government of Quebec has itself taken a number of initiatives along these lines and should encourage towns and cities to do likewise in seeking to achieve structurally balanced and sustainable budgets.

Introduction

A number of fiscal indicators suggest that a change is gradually occurring in the approach governments are taking towards a sustainable balance in the management of public accounts in Canada. Little by little, provincial governments and municipalities are incorporating financial policies and management rules based on the structurally balanced and sustainable budget model into their operating and capital budgets. Strategies for reining in debt, eliminating budget deficits and avoiding deferred maintenance and pension fund deficits, while building up reserves or contingency funds fall into this category.

The *Fond des générations* (Generations Fund), established in 2006 to help Quebec eliminate its provincial debt, is an example of a sustainability initiative. For the Quebec government, the creation of the fund was an important milestone in implementing a long-term financial policy, even though, strictly speaking, it still does not have a long-term fiscal plan for its budget as a whole. On the other hand, it has put forward budget financing plans for the years up to 2016–2017 in areas that account for significant portions of its annual budget: health, university education and ground transportation infrastructure.

When a city decides to pay cash for infrastructure work, the decision has an effect on both its financial policy—that is, its borrowing policy and level of debt—and its operating budget, since the decision will be reflected in its budget allocations. These actions, though seemingly insignificant, actually mark a profound shift in the way the administration of public finances is conceived, professional and technical resources are organized, and standard operating procedures and practices are determined.

This shift is not unique to Canada; it is taking place throughout North America. The recession of 2008 began in the United States, but quickly spread to the rest of the world, and its impact on the North American economy, including on Canada's cities and various regions, is still being felt. While neither the Government of Canada nor the Government of Quebec has yet succeeded in rebalancing its annual operating budget, both of them expect to do so over the course of the 2015–2016 fiscal year.

What Is a Structurally Balanced and Sustainable Budget?

When a public administration, at whatever level, passes a structurally balanced budget, its aim is not only to balance the books for each fiscal period, year after year, but also to protect the administration against risks of all kinds and from all sources that might compromise its ability to carry out its mission, fulfil its mandate and respect its commitments.

The traditional budget process consists in taking the current budget as a point of departure, adjusted, as well as possible, by a factor related to economic growth—or, as the case may be, cost increases—and then adding to it new expenses attributable, for instance, to the commissioning of new facilities or the implementation of new programs. Reconciling spending with revenue is not a problem when the economy is growing, but when times are bad, balancing public accounts usually requires lengthy, painful, often acrimonious negotiations. The budget may then seem to be balanced, but nothing guarantees that the outcome will be recurring and sustainable—quite the contrary.

A public administration can very well balance its budget estimate for a given fiscal year by resorting to convenient expedients, such as selling assets, benefiting from timely surpluses and unexpected, one-time inflows, or by dipping into available reserves originally intended for other purposes than to pay for current expenditures. By balancing the budget in this way, however, it will not achieve structural balance, since in its next fiscal year, it will again find itself in the same situation of shortfall or imbalance between revenue and spending.

A sustainable return to balanced public accounts depends far more on public organizations instituting a disciplined strategy than on an expected and hoped for economic recovery that generally arrives long after budget day.

In Canada and the United States, a number of local and regional governments have understood this and have implemented policies designed to achieve structural balance in their financial management. Their budgets include new funds reserved for specific purposes, with tight controls applying to how the money may be used. Their financial policies define management rules that force not only their executives and managers, but also their political decision makers, to adhere to very demanding requirements.

The City of Yellowknife is a case in point. Back in 2000, the capital and economic hub of the Northwest Territories adopted an ambitious budget management guide based on a set of best practices of the Government Finance Officers Association (GFOA),[2] a professional organization of financial managers in Canada and the United States. Another case is that of the City of Markham, Ontario, where adopted practices prohibit using surpluses to balance the budget each year. In Quebec, the City of Gatineau has established a reserve fund for the purposes of infrastructure life-cycle spending.

These few examples show that some Canadian cities of different sizes, with different geographic and economic contexts, have recently adopted policies that, while new to them, have long been associated with structurally balanced budgets.

Essential Components of a Structurally Balanced Budget

A structurally balanced budget can be configured in a wide variety of ways, depending on the public administration committed to achieving it on a sustained basis, but it usually includes the following components:

- Strategic planning (and periodic review thereof) in connection with the organization’s mission, mandate, values, vision, objectives and future issues
- Performance appraisal
- Financial risk management
- Long-term financial plan
- Financial contingency policy
  - Reining in debt: debt limits, borrowing targets, cash payment, etc.
  - Funds and reserves, and management policies governing them
  - Annual maintenance and deferred maintenance deficit
  - Disposition of surpluses
- Revenue policy: recurring and non-recurring revenue, fees for services

These policies usually include a statement of principle, an objective and one or more established and accepted management and accountability rules that have been approved by the responsible authority, i.e., the municipal council in the case of a town or city, or the legislative assembly in the case of a province or territory, in Canada, or of a state in the United States.

Before and After 2008

In the last quarter of the 20th century, which saw skyrocketing energy costs and strong consumer price inflation, Canadian provincial governments operated with budgetary deficits, financing shortfalls chiefly by going deeper into debt. In the 1990s, the issue of balanced budgets again became a hot topic of political debate. The desire to embrace the “zero deficit” objective prompted the adoption of binding commitments: in 1995, for instance, Manitoba brought in balanced budget legislation that outlawed deficit spending; Quebec made the same commitment the following year.[3]

During the same period, towns and cities, which were generally prohibited from running deficits, realized that simply balancing the budget, which was becoming harder and harder to do each year, was not enough to enable them to resolve the major deficit issues they faced with respect to maintaining their aging infrastructure and funding their social commitments, nor did it shield them from economic shocks or unexpected setbacks.

Public administrations therefore undertook to change their budgetary approach *before* the 2008 financial crisis, which sorely tested the confidence that depositors, investors and taxpayers had placed in financial institutions and governments.

In addition, the economic crisis forced several states to shelve the policies they had adopted to achieve annual balanced budgets. Even governments that had solemnly, sometimes through legislation, undertaken to no longer run budget deficits had to resign themselves to an imbalance in their public accounts. Since then, the objective of returning to balanced budgets has become a common theme in all budget speeches in Ottawa, as well as in Quebec City and Canada's other provincial capitals.

To regain the confidence of their customers and meet the requirements of regulatory authorities, Canadian financial institutions have improved their accountability by complying, since 2011, with the International Financial Reporting Standards (IFRS) and, since 2013, with the Basel accords on minimum liquidity and capital requirements.[4] The purpose of this prudent regulatory framework is to strengthen the capital base of financial institutions to make them better able to withstand sudden liquidity crises without having to rely on government bailouts.

Public administrations are struggling with the same problem. Those that established “rainy day funds” for the purposes of stabilizing their finances, reducing debt or funding essential operations did so in order to protect themselves against the disruptive impact of an unstable economic situation or the cumulative effects of the underfunding of certain responsibilities. The Quebec provincial government’s Generations Fund and the City of Gatineau’s life-cycle reserve are two examples of this kind of contingency measure.

In a report published in the summer of 2013, the National Association of State Budget Officers (NASBO) noted that most state governments had reacted to falling revenue in tough economic times by cutting spending and raising taxes, but also by drawing on their rainy day funds. Yet the funds set aside in those reserves were not sufficient to stabilize their budgets. The yield from their sources of revenue remains unreliable, and the element of risk involved in efforts to achieve balanced budgets grows and undermines states’ financial health. Serious consideration must therefore be given to increasing the amounts set aside in these contingency reserves.

At least four states have taken action in this respect. Beginning in 2013, in Georgia, Oklahoma and Virginia, the amount that can be held in the rainy day fund will climb from 10% of the annual budget to 15%; South Carolina has taken a similar step by increasing its reserve fund from 3% to 5% of its annual budget.

State treasury officials are convinced that a radical change is required in the management of public finances. In this regard, NASBO issued a warning last summer that should also be heard here: “States cannot afford to adopt a wait-and-see course of action on budgeting decisions and program reforms. In order to ensure that states continue down a path of fiscal sustainability, budgeting for current expenditures must not only consider current revenues but also account for future obligations.”[5]

Clear View of How Things Stand

There aren’t many Canadian provinces, U.S. states or cities—if any at all—that can claim to have fully incorporated a structurally balanced and sustainable budget into their financial policies. What is actually happening is that more and more public administrations, at all levels of government, are adopting component parts of such a budget and adapting them to their specific financial strategies.

The transition from a temporarily balanced budget to a structurally balanced, sustainable one, albeit in an incomplete form, can take many years. Even in cities that have travelled the farthest along this path, the adoption or updating of financial policies and rules of management practice remains an ongoing operation.

In Vaughan, Ontario, the municipal administration had established some 65 dedicated funds and discretionary reserves over the years, with the amounts accumulated in them exceeding $300 million last year. The City held reserve funds for a large number of activities—snow clearance, park development, vehicle replacement—as well as for financial stabilization purposes, to the point where, in 2012, it decided it was time to restructure its management policy and practices in the form of a new Consolidated Reserve Policy.[6] In the process, the administration merged three reserves, eliminated about fifteen and established two new ones—the innovation reserve and the information technology management reserve—which were added to the existing ones that had been kept. Management by means of funds and reserves is deeply rooted in the institutional culture of this city on the outskirts of Toronto.

For a city that embarks on an initiative to institutionalize a structurally balanced and sustainable budget, the first step required is to take a critical look at its budget process and financial situation. In short, it must take the time to get a clear view of how things stand.

As a means of achieving this goal, the GFOA's Distinguished Budget Presentation Award Program can prove very useful. It is the only public administration excellence certification program in North America, developed on the basis of the corpus of knowledge and know-how of some 1,430 municipalities and local and regional organizations.

To obtain GFOA certification of the excellence of its budget presentation in 2012, the City of Quebec had to completely overhaul its budget process. As a result, a new budget and financial management culture was progressively established in the administration, leading to the adoption of new financial management structural policies and rules of practice. The City of Quebec's administration had to devote several years' work to this, as the municipality's auditor stated, in his 2007 annual report,[7] after applying the GFOA's criteria of excellence, that the "budget process has not yet reached the level of maturity appropriate for a city of the size of Quebec."

GFOA certification of excellence in budget presentation is granted when the public organization applying for it complies with 27 rating criteria used to evaluate the budget's effectiveness as a policy document (strategic planning, long-term financial policies), financial plan (funds and reserves, borrowing and debt levels, etc.), guide to operations (performance indicators and benchmarks, staffing changes, etc.) and internal and external communications tool.

In Quebec, CIRANO has been helping universities, cities and public corporations to implement this budgeting model. In 2013, the Société de transport de Montréal [public transit authority], the Office municipal d'habitation de Montréal [city housing board], McGill University, Université Laval, the City of Quebec and CIRANO obtained their certificates of excellence.

Examples of Adopted Policies

With the help of examples taken from the corpus of best practices compiled by the GFOA and from the financial reporting documents of cities in Quebec and elsewhere in Canada, let's now take a look at how new financial planning and budget management rules can be implemented.

Strategic Planning

Since the turn of the century, many Canadian cities have developed a vision of their development over the next 20 or 30 years. In most municipalities, this initiative has involved long-range planning of financial and tax issues.

One very concrete example is that of the City of Calgary. Alberta's largest city has developed a vision of its future over the next 100 years *(Imagine Calgary)*, set its objectives and targets for the next 10 to 30 years *(Plan It Calgary)* and adopted a services plan *(Services and Infrastructure for Citizens)* and a *Long Range Financial Plan*.

The City of Calgary's objective is to reduce the share of revenue it takes in from property taxes to 25% by 2036. Canada's oil and gas capital has also set itself another target that will have an influence on its capital spending for public transit, as well as for other purposes: in 25 years, at least 30% of the energy used by Calgarians will come from renewable sources.

In Ontario, in the mid-1990s, the City of Toronto produced a number of subject- or sector-based plans for its future *(Horizon 2020)*, which it has periodically been updating as separate publications—*Long Term Fiscal Plan, Strategic Plan, Long Term Transportation Plan and Funding Strategy*. More recently, in 2010, it adopted *Toronto's Official Plan*. With these objectives, the City is seeking to overcome its financial problems by making up a structural spending shortfall of $75 to $100 million a year, while at the same time catching up on the long-overdue upgrading of its infrastructure.

In Quebec, the City of Gatineau has been moving closer to the general concept of sustainable development by implementing its 2009–2014 development strategy. Gatineau's financial reports refer to sustainable management of municipal finances and exemplary governance. Its 2013 budget includes a new item, "life-cycle reserve," that is rarely seen in Quebec municipal budget documents.[8]

Performance Appraisal

For the last 10 years or so, cities in Ontario and Quebec have been measuring the efficiency and effectiveness of the services they provide by means of management indicators. The governments of the two provinces have established programs making use of the indicators mandatory.

In Ontario, municipal administrations give updates on their results by issuing financial information reports and are required to publish them, in a form of their own choosing. In 2012, the performance appraisal concerned 13 services, including drinking-water supply, roads and building services. That same year, the Ministry of Municipal Affairs and Housing published all the results for 2009 and 2010, so that municipal managers, elected officials and taxpayers now have data that can be used for comparative analysis.

In Quebec, towns and cities file their reports with the Ministère des Affaires municipales, des Régions et de l'Occupation du territoire [Department of Municipal Affairs, Regions and Land Occupancy]. In 2011, performance measurement was compulsory for 17 services or areas of activity, including fire safety, selective pickup of recyclables and financial strength. The data are made available to municipal administrators. A number of cities publish their results unadorned on their websites, exactly as they filed them with the department.

Financial Risk Management

Defining and measuring the risks that financial issues represent for cities has still not become a component part of their long-term financial planning vocabulary. Financial reporting documents produced by Canadian municipalities do not contain any chapters or headings on this topic, although this does not mean the subject is ignored.

The City of Quebec's 2013 budget includes a brief analysis of "threats" that could end up derailing the municipality's long-term planning (through to 2016). Here are four such threats:

- An interest rate increase greater than what current economic forecasts are calling for
- An increase in the prices of natural resources
- Lower growth in property assessments as a result of a sharp drop in the value of new construction starts
- Provincial government withdrawal from the existing fiscal agreement and from the funding of infrastructure programs or the transfer of new responsibilities

Some cities, especially Montreal, Quebec City and Rimouski, see the funding of municipal employee pension plans as an unavoidable issue. In Quebec, 108 municipal administrations manage 216 defined-benefit pension plans, most of which are in a deficit position, with their sharply rising costs quickly becoming a threat to the cities' current and structural financial equilibrium. For the time being, no framework suitable to the municipalities has been defined that would help them resolve this issue. Municipal employers, the unions, public employee associations and the Quebec government have all been studying and discussing this topic, with the government acting as the pension plan legislator and regulator.

Long-Term Financial Plan

Any sustainable approach to achieving a structurally balanced budget necessarily involves a degree of long-term planning, generally with a 10-year horizon, and requires updating if a passed budget is departed from. While provincial and state governments make economic growth forecasts and count on the impact of this growth on job creation and tax revenue, cities are always slightly slower to react to these temporary or structural shifts in the overall economy. Their main source of revenue remains the various taxes they raise on their property-tax base.

In 2013, Calgary had a population of 1.15 million. The City's administration is forecasting that the population will increase by 120,000 over the next three years and that it should double over the next 50 years.

The City of Calgary drew up its first long-term financial plan for the 10-year period from 2007 to 2017 and has been updating it periodically since then to reflect changes in its situation.[9] Its biggest challenge is to anticipate demand for infrastructure and services, while at the same time keeping its existing infrastructure in a good state of repair and continuing to provide citizens with the quality of service they have come to expect.

Between now and 2019, the shortfall between revenue and operating expenses will widen to reach $200 million a year; the City will need another $600 million annually to meet its infrastructure and equipment needs. It is estimated that "the City will face significant annual operating and capital budget funding shortfalls in the next decade, which cannot be addressed through projected levels of existing revenue sources," according to the City of Calgary's *Business Plans and Budgets (2012–2014).*

Building strong, amicable relationships with the Government of Alberta, examining various forms of partnership with the private sector, diversifying sources of revenue and improving the productivity of municipal services are all components of the city administration's continued action plan.

In 2003, British Columbia passed a law that requires cities to annually prepare a five-year plan for balancing revenue with expenditures;[10] if a budget shortfall occurs one year, the municipal administration must make it up in the following budget year. It is highly unlikely that the City of Burnaby, a municipality of 223,000 people in the Greater Vancouver Area, would have to resort to this kind of procedure, as it operates without taking on any debt; by the end of 2014, it expects to have reserves of over $677 million in its administration, capital investment and contingency funds. Burnaby has a reputation for being one of the best-run cities in Canada.

In Quebec, cities plan their infrastructure and equipment capital investment over three years by establishing a three-year capital expenditure program that is reviewed and adjusted each year. In 2012, as part of its 2013–2015 capital expenditure program, the City of Montreal drew up an initial long-term capital plan for the period from 2013 to 2022.[11]

For those 10 years, the City, which has a population of 1.6 million, is planning total capital expenditures of $20.6 billion, but it will have a shortfall of close to $700 million, including $240 million for roads. In addition to conducting a very strict review of the planned projects and retargeting efforts to focus more on projects that will generate wealth and spur economic growth, the municipal administration is counting on making up the accumulated capital shortfall by implementing a funding strategy that includes diversification of its sources of revenue. "The City of Montreal is currently exploring the possibilities offered by other sources of funding, such as vehicle registration taxes, parking taxes, fuel taxes and tolls, as a means of paying for greater investment in road infrastructure."[12]

A long-term financial plan makes the entire budget operation foreseeable from one year to the next, to the point where cities no longer hesitate to announce tax rate increases three years in advance. Thus, Calgary taxpayers knew in 2011 that municipal property tax rates would be going up by 6% in 2012, 5.7% in 2013 and 6.1% in 2014. This is the price to be paid to ensure sustainable and recurring balanced municipal budgets over the short and medium term.

In its three-year plan covering 2012–2015, the City of Markham, Ontario, set its financial and budget targets in what it refers to as six "strategic" areas. Assuming a 3.33% increase in the property-tax base, the administration forecast that its tax rates would rise by 4% to 5% over that period. Up-front, transparent forecasts like this facilitate accountability to taxpayers.

Quebec's towns and cities still present their budget forecasts for the next fiscal year by comparing them with the corresponding data for the current year and sometimes also for the previous year. They make comparisons with the past, but do not project into the future. They could, however, like many cities elsewhere in Canada and in the U.S.A., institute a financial plan covering both their projected capital expenditures and budget forecasts, and present them annually on a five-year basis, to improve planning for the future.

Financial Contingency Policy

To protect themselves against shocks to the financial system and economic downturns, public administrations in North America have been trying to strengthen their structural financial levers by adopting policies and rules of practice that, in principle, bind both politicians and administrators through shared values of prudence and objectives of predictability and resilience. Public treasury officers do not like unpleasant surprises that upset their well-laid financial plans.

In its corpus of best practices, the GFOA recommends maintaining a liquidity reserve equivalent to at least two months of the operating budget at all times.

Even more than the higher-level governments that oversee them and also contribute to the funding of their capital projects, cities have been very active, and sometimes highly creative, in the area of financial contingency. Their contingency toolbox includes very well defined financial management policies, reserve funds and reserves for the future. Some examples are given below.

Reining in Debt

Keeping Level of Debt in Check

Many cities have set strict limits on their borrowing programs, so as not to overload their annual budgets with debt-servicing costs that could reduce their room to manoeuvre.

In 1996, the City of Vaughan, Ontario, set its debt limit at 10% of its annual revenue, well below the 25% limit authorized by the province.

In Quebec, the City of Lévis has adopted the following guidelines:[13] the amortization of debt must not exceed the estimated service life of the item for which the funds were borrowed; the ratio of municipal debt to total property value must remain below the average for the 10 Quebec cities having populations of over 100,000; and budgeted debt-servicing costs must not exceed 20% of total revenue. The City of Sherbrooke has adopted other guidelines: its total debt must not exceed 100% of its annual revenue, and the cost of debt servicing must not exceed 15% of revenue; in 2012, debt servicing accounted for 11.5% of municipal budget spending.

Paying Cash

Many cities have chosen to break with the widely accepted practice of financing infrastructure projects through borrowing. They have instead adopted a policy of paying cash for their capital expenditures, so as to reduce the need to take on debt and preserve manoeuvring room in the budget for the future. The City of Laval has been increasing its efforts in this respect from one year to the next: the proportion of the budget allocated for cash payment has risen from 25.5% in 2012 to 27.5% in 2013.

The City of Quebec has adopted a debt management plan that combines cash payment with setting aside funds for advance payment, with the goal being to pay for 70% of its capital expenditures by 2021 without resorting to taking on debt.

Debt management plan

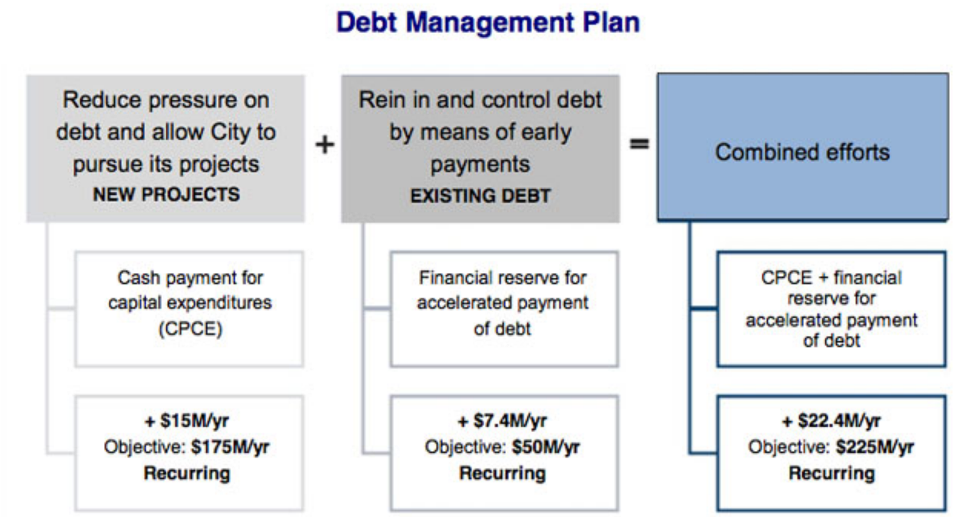

Figure **10-1**
Source: City of Quebec, 2013 budget.

Funds and Reserves

The master policy for a structurally balanced and sustainable budget involves establishing funds and reserves for specific purposes, so that services and programs do not have to be interrupted when economic times turn bad. The purpose of stabilization or contingency funds, often called rainy day funds, is to help preserve a balanced budget when an unexpected expense or sudden drop in revenue occurs. Canadian winters are unpredictably harsh, and cities must prepare financially to deal with them. A number of cities have set up winter maintenance or snow removal funds so that their financial positions can withstand years in which snowfalls exceed what weather forecasters call “seasonal normals.” Under its contingency policy, the City of Mississauga is required to maintain a winter maintenance reserve equal to 50% of the current year’s snow removal budget.

The City of Quebec follows the same policy and sets itself a target of $20 million. Under its policy, the City may draw on the reserve only when the actual costs exceed what was budgeted and it is impossible to make up the shortfall from another source of funding.

The same standard applies to Montreal’s boroughs: any budget surplus with respect to snow removal must be transferred in its entirety to the snow removal reserve, up to a ceiling of 50% of the annual snow removal budget.

Reserve funds are also used to pay for certain major operations deemed to be essential or top priorities. This is the case of the City of Montreal’s water fund, which taxpayers have been paying into through a special dedicated municipal tax since 2004. Studies conducted in 2005 estimated that investment of the order of $10 billion was needed to make up for years of underbudgeting and underfunding of the City’s water supply infrastructure. At the moment, according to City plans for 2013 to 2022, a little over $5 billion is slated to be spent on waterworks rehabilitation.

When a reserve fund is established, rules are also adopted for how money will be appropriated for the fund and how it will be used, as well as for accountability.

To achieve a balanced budget each year without cutting services or raising taxes, many cities reallocate the surplus from one year to the following fiscal year, or draw from a stabilization fund where they have placed unallocated surpluses. The City of Vaughan follows this practice: since 1994, it has had a policy allowing it to draw up to $2.5 million from the current year's surplus in order to ensure a balanced budget the following year; any surplus above this amount must be transferred to the tax rate stabilization fund or the working-capital reserve.

In some cases, cities raise a dedicated tax, like the one for Montreal's water fund or that for the City of Longueuil's infrastructure fund. The City of Longueuil also directly allocates growth in its revenue from the real estate transfer tax to the funding of its capital expenditures.

In their bylaws establishing reserve funds, a number of cities have specified how and under what circumstances the administration may use them. The City of Quebec's contingency fund, for example, must contain an amount equal to 2% of the operating budget—up to a maximum of $20 million—and may be used only when an event beyond the City's control occurs; the expenditure must arise from a legal obligation or an act of God.

Annual Maintenance and Deferred Maintenance Deficit

Before giving the green light to work on a new facility, any public administration must assess the repercussions of running it on its operating budget. Most cities do this and take it into account when deciding whether or not to go ahead with the capital project. This widespread management practice usually applies to new facilities and, less often, to existing installations where the financing has been amortized and the operating costs have long been incorporated into the basic budget allocation.

Life-cycle reserves are used in many Canadian cities, but they are rarely referred to under this name in the budgets of cities in Quebec. The purpose of such a special contingency reserve is to plan for the eventual replacement of equipment or infrastructure for which appropriations are spread over its estimated service life. In general, the life-cycle reserve is distinct from the reserve fund, which is established to cover major expenses resulting from unexpected equipment or infrastructure failure.

In Quebec, the Sustainable Development Act of 2006 sets out the principle of cost internalization, whereby the value of goods and services must reflect all the costs they generate for society throughout their entire life cycle. The Act applies to Government of Quebec departments and agencies; in the first implementation phase (2008–2013), municipalities, school boards and health care institutions are exempt. Nevertheless, nothing prevents a municipality from basing its policies on the Act and referring to it in devising its own municipal sustainable development strategy.

The City of Gatineau is one of the few Quebec cities to have established a life-cycle reserve for the maintenance of its new facilities. In 2013, it made a discretionary payment of $2 million from its regular budget to its life-cycle reserve.

In 2012, the City of Vaughan adopted a particularly strict policy on infrastructure life-cycle contributions. When it approves a new infrastructure capital project, it undertakes to make an annual contribution to a reserve based on life-cycle replacement principles with a view to eventual replacement of that infrastructure. In addition, the municipal administration indexes the contributions by making an inflationary adjustment for this type of infrastructure, to ensure that the contributions it has set aside for the replacement will always keep pace with future costs.

Disposition of Surpluses

The most widespread practice involves transferring budget surpluses or one-time revenues into a reserve fund.

Revenue Policy

The rule of practice recommended by the GFOA is quite simple: recurring revenue should be used to pay for the public administration's recurring or statutory expenses, such as labour costs and the fixed costs of certain services. Non-recurring revenue should be used to pay for extraordinary, non-recurring expenditures or to make contributions to special reserve funds.

By recurring revenue, the GFOA means the portion of revenue that a public administration can reasonably expect to receive year after year, such as a city's property tax revenue. A government can count each year on taking in revenue generated by the goods and services tax and can make predictions about how much it will receive in the future based on the economic forecasts it used to develop its budget assumptions.

The City of Yellowknife's one-time revenue management policy allocates all non-recurring revenue to its reserve funds, debt reduction or non-recurring expenditures such as capital acquisitions.

Fees for Services

Cities get most of their funding from tax revenue. Published budget documents for 2013 show that these taxes account for two thirds of municipal revenue in Montreal and close to three quarters in Gatineau.

Charging fees for services is municipalities' second biggest type of own-source revenue. In Quebec, revenue from fees for municipal services is usually lumped under the heading of "other revenue"; in 2013, other revenue accounted for 17.4% of the City of Montreal's budget and 8.2% of Gatineau's budget.

According to the findings of a study by CIRANO's excellence in budgeting research group,[14] most cities have fee-setting practices, but very few of them have a fee-setting policy. A fee-setting policy defines the application framework and principles to be followed for calculating appropriate fees and updating them periodically. Unlike a municipal tax, the purpose of which is to spread charges amongst all taxpayers, fees are designed to make users pay for all or part of the operating costs of the services or facilities they use, depending on the municipality's policy. The fee-setting policy should therefore be based on the principle of recovering actual operating costs.

CIRANO's excellence in budgeting research group has concluded that Quebec towns and cities do not take full advantage of the potential of this financial leverage because they do not conduct systematic analyses of changes in the comparable costs of their services and facilities.

In a 2008 report, the Groupe de travail sur la tarification des services publics du Québec [working group on the pricing of Quebec public services] estimated that Quebec cities would have taken in over half a billion dollars if they had set user fees so that fee-based revenue accounted for the same proportion of total revenue as in the average Canadian municipality.

In a structurally balanced and sustainable budget, fees for services must be set in relation to total costs and must take into account both direct costs (wages, salaries and benefits, other operating costs) and indirect costs (shared administrative expenses, operating overhead, current maintenance expenses and deferred maintenance deficit expenses).

Need for Legislative Framework

To be sustainable, the transition towards a structurally balanced budget requires a certain amount of courage, perseverance and no doubt some solid safeguards. In this respect, the U.S. experience is enlightening.

In at least 16 states,[15] the governor needs a qualified majority consisting of two thirds or three quarters of the elected members of both houses to be allowed to draw from a reserve to balance the budget. The governor of Alabama must obtain a two-thirds majority in the legislature to draw from the education fund, and if this majority is obtained, the state must necessarily pay back into the fund at least $21 million the following year and $8 million per year thereafter, up to a ceiling of $75 million.

In Iowa, the liquidity reserve may be used to pay for an emergency, non-recurring expense, but the governor must first obtain the approval of three quarters of elected members if the expense would push the reserve below a level equivalent to 3.75% of the forecast revenue for the fiscal year in which the drawdown is planned.

In Canada and at the municipal level, governments do not have legislative guidelines similar to those in effect in some U.S. states. In Canadian provincial legislatures, a simple majority is needed to pass a budget implementation act or amendment; in cities in Canada, a simple majority is sufficient to adopt the budget, the capital expenditure program and the various implementation bylaws. While the establishment of new dedicated funds comes with an accountability obligation for their management, a simple majority vote of the elected members is all that is needed to amend that obligation.

There are good grounds for wondering whether the City of Montreal administration would have found it so easy to amend its water supply system management strategy in 2013 if guidelines similar to those in effect in several U.S. states had been in place. That year, the municipal administration decided to ease off on the water fund contribution program by reducing the rate of the dedicated water fund tax in order to cut municipal taxes. In doing so, however, it caused a huge increase in the anticipated deficit of the long-term capital expenditure plan. In conjunction with slow progress in the rehabilitation work, the anticipated deficit has risen fourfold: last year, as part of its 2013–2015 three-year capital expenditure program, the City of Montreal anticipated a deficit of $27.6 million for 2022 in its water supply system rehabilitation program; in its 2014–2016 capital program, it reported an anticipated deficit of $114.7 million.

Conclusion

It seems that all over North America, the administration of public finances has turned a corner and is progressively heading in the direction of structurally balanced and sustainable budgets. The shock wave that reverberated through the economy in 2008 probably accelerated this shift, and public organizations have learned from it.

In Canada, progress has been seen, especially in municipal treasury offices and city councils. In 2012, the Commission du conseil municipal de Montréal sur les finances, les services administratifs et le capital humain [Montreal municipal council board on finances, administrative services and human capital] recommended that the City table a budget that would be structurally balanced over the next three years. Although this pioneering gesture was not publicly discussed much, it was still highly significant, in that it constituted an instance of politicians urging administrators to innovate.

In future, issues associated with budget strategy, the budgetary process and financial governance need to be tackled as a coherent whole at all levels of public administration and by all stakeholders—political decision makers, public administrators and taxpayers—together. While municipalities can accomplish a great deal on their own, they will need the approval and guidance of provincial legislators to help them persevere in their efforts to achieve structurally balanced and sustainable budgets.

Many cities in Canada have adopted long-term sustainable development plans. In most cases, these plans focus on policies and practices related to development, the environment and public health. Incorporating sustainable development principles into municipal budget policies and initiatives to achieve structurally balanced budgets is something that still remains to be done.

Here, "sustainable" means the same as it does in the Quebec Sustainable Development Act, which sets out the guiding principle of cost internalization that should be of concern to all public administrators. Under this principle, the value of goods and services must be reflected in their life cycle, from the design stage to final disposal.

The Quebec government should encourage and even promote the adoption of contingency budgetary policies by local organizations. For instance, it could require that a reserve be established to prevent a maintenance deficit when it subsidizes the construction of a new public facility. It could also set an example by requiring the service agencies it funds to do likewise. Over the long term, the financial situation of all public administration, from the top level of government down to the bottom, would be healthier and stronger as a result.

A number of Canadian cities have realized they will no longer be able to maintain the same levels of services without rethinking their policies, or even their institutional culture, concerning budget and financial management, especially with respect to their capital expenditures and investment. Modestly, one by one, policies specific to structurally balanced and sustainable budgets are being incorporated into the toolbox of best municipal management practices.

The establishment and maintenance of a rainy day fund constitutes an integral part of achieving a structurally balanced and sustainable budget. It is a safeguard that no government and no municipality can do without in seeking to protect itself against future recessions or disasters.

We have noted the cases of a few Canadian cities, such as Vaughan, Ontario, and Burnaby, British Columbia, where the financial reserves accumulated in recent years have helped to stabilize the municipality's financial situation. These examples should provide inspiration to municipal administrations elsewhere in Canada.

At least 10 years of continuous efforts are required to effect a sustainable rebalancing of public accounts—far longer than the election cycle of most elected officials. Recent progress in bringing structural reforms to budget administration therefore remains fragile and at the mercy of political whims.

Experience has taught us that it is essential for public organizations in Canada, now that they are on the right track, to persevere in implementing the major components of a structurally balanced and sustainable budget.

Adopting a wait-and-see attitude will not ensure a sustainable future.

Notes

↵1. With thanks to Alain Duhamel for his help with the research and writing, and to Samira Bentisse and Matthieu Strub for their help with the research.

↵2. The GFOA has some 17,000 members in the United States and Canada. The organization's mission is to promote best financial management practices through research, comparative analysis and certification.

↵3. The subject of budget rules at the provincial level is discussed more specifically by Eklou, Farvaque, Foucault and Joanis in Chapter 11 of this book.

↵4. Prudential framework designed to control bank risks.

↵5. National Association of State Budget Officers (NASBO), 2013, *State Budgeting and Lessons Learned from the Economic Downturn*, p. 36, retrieved October 8, 2013, from http://www.nasbo.org/sites/default/files/State%20Budgeting%20and%20Lessons%20Learned%20from%20the%20Economic%20Downturn-final.pdf.

↵6. City of Vaughan, 2013–2017 Final City of Vaughan Budget.

↵7. Report of the auditor general of the City of Quebec, December 2007 [in French]. Retrieved from http://www.ville.quebec.qc.ca/publications/docs_ville/rapport_verificateur_general_2007_tome2.pdf.

↵8. City of Gatineau, *Budget 2013* [in French]. Retrieved from http://www.gatineau.ca/docs/la_ville/administration_municipale/budget/budget_2013/budget.pdf.

↵9. City of Calgary, Long Range Financial Plan, 2009, Update/2010–2019.

↵10. Community Charter of the Province of British Columbia. Retrieved from http://www.cscd.gov.bc.ca/lgd/gov_structure/community_charter/finance/financial_plan.htm.

↵11. City of Montreal, Programme triennal d'immobilisations 2013–2015 [Three-year capital expenditure program, 2013–2015], p. 31.

↵12. City of Montreal, Programme triennal d'immobilisations 2012–2014 [Three-year capital expenditure program, 2012–2014], p. 31.

↵13. City of Lévis, Politique de gestion de la dette [Debt management policy], July 2013.

↵14. Groupe d'excellence en budgétisation, *La tarification des services publics : constats et recommandations pour les municipalités du Québec*, CIRANO, August 2012.

↵15. Alaska, Delaware, Hawaii, Iowa, Louisiana, Michigan, Missouri, New Hampshire, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Washington and Connecticut. Note that these votes are not systematic: this supermajority sometimes applies only in certain specific situations, and in other cases, the governor may draw from the fund without having to seek permission from the legislature.

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The Age Old Question—How do we Account for Pensions?

Bailey Church; Co-Leader, Public Sector Advisory Service, KPMG, Ottawa; bchurch@kpmg.ca
Shannon Magnusson, CA; Senior Manager – Assurance, KPMG, Winnipeg; smagnusson@kpmg.ca

How we account for pensions is accounting's equivalent of the search for the holy grail—how to best match pension costs with services rendered by an entity's employees. Pensions date back as far as the 1600's, and pension accounting has evolved significantly ever since. Reflecting on this historical evolution of pension accounting can provide us a useful context for understanding current accounting and reporting issues.

By way of perspective, we'll start with a journey through time. Flashback to the early 1960's—prior to the Beatles famous American invasion in 1964. At this time it was common for entities to simply use cash accounting for pension costs. Entities would simply expense their annual contributions to their pension plan. Entities that had surpluses in their plans could make reduced or no contributions in a given fiscal year, resulting in reduced or no pension expense. This had an adverse impact on comparability of financial reporting between entities—one entity could report very different expenses from another depending on their required contribution to the pension plan that year. This also led to variability in net income reported, as pension contributions varied year to year. This early accounting was indicative of a focus on the Statement of Operations, not the Statement of Financial Position, as no liability was reported.

With the move to accrual accounting in the mid 1960's, entities began recognizing accrued benefit obligations on the Statement of Financial Position, and recognized that obligation on the Statement of Operations over the estimated average remaining service life of employees.

Let's jump ahead now to the 1980's—the Beatles have given way to Wham and MTV. At the same time a fundamental shift in underlying economic assumptions was leading to increased volatility with respect to accrued benefit obligations and expenses being reported by entities for their pension plans. The early 80's was marked by a sustained increase in interest rates (which increased from 10% at the beginning of the decade, to 18% by 1982), as well as high stock market volatility leading up to the substantial market correction of 1987. Sustained high interest rates led to higher discount rates being used to measure accrued benefit obligations, and hence much lower obligations. This volatility led to the perception of a disconnect between information reported on the Statement of Financial Position, and the Statement of Operations. In 1985 FASB adopted new pension accounting rules (the first introduction of Statement 87, *Employers' Accounting for Pensions*) with the objective of reducing volatility of earnings arising from actual returns on plan assets. These rules were intended, in part, to ease the Statement of Operations impact from plan changes that granted future pension benefits based on past service. As well, in 1985 International Accounting Standard (IAS) 19 was introduced—*Accounting for Retirement Benefits in Financial Statements of Employers*. Eventually, in the late 1990's the Canadian Institute of Chartered Accountants (CICA) introduced Handbook Section 3461, *Employee Future Benefits*, which was based on the defer and amortize concept.

Over this time the accounting for pensions has been based on three underlying principles:

1. **Delayed recognition.** At any point in time, certain changes in the pension obligation and in the value of assets accumulated to meet the obligation (even though the changes have been identified

and quantified) have not been recognized for accounting purposes.
    - These changes stem from experience, actuarial revaluations and changes in the past service obligation related to plan amendments.
2. **Net cost.** The recognized pension-related events and transactions are reported as a single net amount of pension expense. This practice aggregates several different costs, such as compensation cost, interest cost and returns earned.
3. **Offsetting.** Rather than carry pension fund assets as assets and the unsettled pension obligation as a liability on the balance sheet, a net pension asset or net pension liability is carried on the Statement of Financial Position.

Continuing our time journey from the late 1990's. We experienced the second longest bull market since 1957 (approximately 10 years in length). At the same time, interest rates continued dropping, from a high of 10% in the late 1980's to as low as 5-6% at the end of the 1990's. Overall, pensions were generating higher and higher returns, while the dropping interest rates led to lower projected obligations. The stock market downturn of 2001 then resulted in significant actuarial losses that substantially eroded or eliminated previous accumulated plan surplus. Meanwhile, we as a population continued to get older, resulting in growing accrued benefit obligations. However, pension expenses did not necessarily have a corresponding increase. In fact, in some cases, entities applying CICA Section 3461, *Employee Future Benefits*, generated credits to income from reversing valuation allowances on plan assets.

This resulted yet again in the perception of an accounting disconnect between the actual value of a pension plan, and the actuarial valuation of the future pension obligations reported on the Statement of Financial Statements. This perceived disconnect from an accounting and reporting perspective could be a persistent challenge going forward due to the aging population and the continuing increase in average life expectancy, which suggests growing obligations for future pension costs. In fact, the Canadian Federation of Independent Business has estimated that “the unfunded shortfall for public pension plans across the country likely exceeds $300-billion . . . or $9,000 for every man, woman and child in this country.” (Gwyn Morgan, “Public-sector packages simply unaffordable,” *The Globe and Mail*, Jan. 19, 2014)

The accounting standards have evolved at different rates to address these challenges, resulting in some fundamental differences between Canadian Public Sector Accounting standards (PSAS) and the International Financial Reporting Standards (IFRS). While PSAS still uses a defer and amortize approach, IFRS has eliminated the deferred recognition of gains and losses. Under IAS 19, *Accounting for Retirement Benefits in Financial Statements of Employers*, actuarial gains and losses are to be recognized immediately by entities in Other Comprehensive Income. This fundamentally shifts the volatility related to pension obligations to the Statement of Financial Position, as changes in the value of defined benefit plans are recognized as they occur. Under PSAS, the accounting and reporting treatment depends on whether an entity is a government not-for-profit organization (and follows the 4200 not-for- profit series), or another government organization. Entities reporting under PSAS with the 4200 not-for- profit series record remeasurements of actuarial gains and losses and other items directly on the Statement of Changes in Net Assets. Entities reporting under PSAS without the 4200 series, expense these remeasurements directly in the Statement of Operations.

Emerging Issues

Growing pension deficits and concerns regarding the long term financial sustainability of pension plans have led to some governments reconsidering the pension plan coverage offered to employees. New Brunswick introduced a shared-risk pension model in May 2012, while the Department of Finance Canada unveiled a proposed framework for Target Benefit Pension Plans in April 2014. These plans are a hybrid of the traditional defined contribution and defined benefit plan models, allowing for both employers and employees to adjust contributions and benefits, up or down, in times of surplus or deficit. They are structured to set clear limits on the volatility of employer contributions. In the event of a funding deficit, part or all of it can be compensated by reducing accrued benefits.

The typical structure of shared-risk pension plans includes funding shared between the employees and the employer (for example, 10% of salaries), and established based on certain risk management goals. If funding levels are not sufficient to meet the goals, a funding deficit recovery plan is mandated. Upon termination or retirement of a member, actual benefits paid or payable to a member (i.e., “the termination value”) are calculated as the member’s share of the plan assets at the time of termination. Benefits payable to plan members cannot exceed funds available in the plan at any given point in time.

Shared-risk plans create an interesting accounting challenge. How we account for pensions has traditionally been based on whether the pension plan is a defined contribution, or a defined benefit plan. Each shared-risk plan must be assessed to see if it is, in substance, more a defined contribution plan or a defined benefit plan. Substantial analysis and professional judgement are required to determine the actual substance of shared-risk plans.

To respond to the emergence of shared-risk plans, and the continued evolution of pension accounting under IFRS, the Canadian Public Sector Accounting Board approved an Employment Benefits project in December 2014. Key issues addressed in this project are expected to include the deferral of experience gains and losses, discount rate, shared-risk plans, multi-employer defined benefit plans and vested sick leave benefits. In addition, the Board is further discussing, in their upcoming January 2015 meeting, the topic of shared-risk retirement benefit arrangements, including consideration of the different views on the measurement of the accrued benefit obligation when retirement benefit arrangements have “shared risk” characteristics.

Conclusion

While pension accounting has evolved significantly since the use of cash-based accounting in the early 1960’s, a number of fundamental reporting challenges still remains. Volatility in the Statement of Operations, comparability of financial reporting between entities, and the perceived disconnect between the Statement of Operations and the Statement of Financial Position remain underlying challenges in how we account for pensions. We have not yet found that holy grail of accounting. As sure as our musical tastes collectively evolved from the Beatles, to Wham, and beyond, the accounting standards too will continue their evolution.

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What's on the Radar: Employee Benefit Costs

Noel MacKay, CEBS; Senior Consultant, Group Benefits, The Williamson Group; NMacKay@williamsongroup.com

Canada has been celebrated throughout the world as having free, universal health care—often being used as a benchmark of healthcare coverage, rightly or wrongly, to support competing interests in the discussion. There is however a lot of healthcare costs outside of the public system defaulting to employer sponsored benefit plans. Extended Health Care (EHC) coverage as part of an employee benefit package is one of the fastest growing costs of an overall compensation plan. It is not uncommon to see ten per cent—or higher—increases year over year, and there is little relief in sight.

What is showing up frequently on the EHC radar, with warning lights going off in all directions, are prescription drug claims covered under employers' plans. For the most part there is little universal coverage for prescription drugs when prescribed and dispensed outside of a hospital setting. Any prescription coming from outside of the hospital setting falls within an employer's plan and, depending on how the plan's formulary has been designed, the risk can be frightening.

Focusing on data from Sun Life Financial on sixteen employers—with 500+ employees in the "public administration/local government" category—we found:

- The average drug claim cost was $67.15
- The average number of prescriptions per employee (employee, spouse, and dependents) per year was nineteen
- The average annual prescription drug spend per employee (employee, spouse , and dependents) was $1,304.00

The first few variables from plan to plan influencing the above rates are the co-pays, deductibles, and formularies—i.e., what drugs are eligible on the plan. The last variable is the collective health status of the employees covered.

When these points were compared to the general population[1] we found that:

- The average cost per claim was eight per cent lower
- The average number of prescriptions per year was twenty-nine per cent higher
    - Nineteen prescriptions per year is approximately what is expected in the fifty to fifty-nine age band
- The average annual prescription drug spend per employee was twenty-one per cent higher.

Lining up the aforementioned data against one more general population data base,[2] we found that the average annual prescription drug spend outside the age range of the twenty one to sixty-four (i.e. no age band was as high) as $1,304.00 per employee.

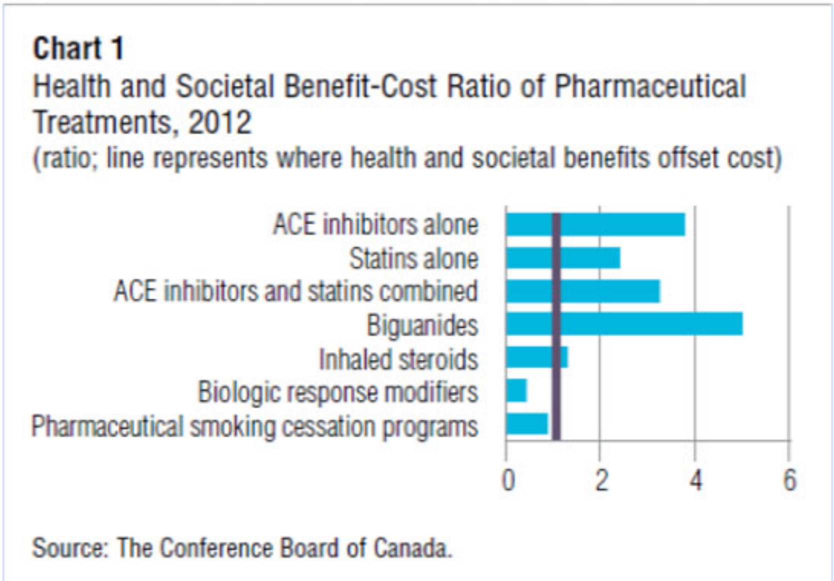
Keep in mind the variables behind the numbers. Comparing one employer's experience against another's is like comparing a first born child to the second born—it can be dangerous.

In general we know that the majority[3] of prescription drug claims are for the following disease states:

Pain	Diabetes	Hypertension	Depression/Anxiety
Asthma/ Chronic Obstructive Pulmonary Disease	Ulcers/Gastro Esophageal Reflux Disease	Infections	Cholesterol

High cost medications for cancers and cancer related treatments, or biologic medications for rheumatoid arthritis etc. make up the rest. The key note on this is that these medications typically fall into the catastrophic claiming bucket which is growing at a faster rate than the run of the mill chronic disease meds.

Is there value in the drug spend? The Conference Board of Canada's *Reducing the Health Care and Societal Cost of Disease: The Role of Pharmaceuticals* report suggests that there is.



Can this info be used to suggest that the employer's spend on presciption drugs also has a positive return? Does an employee taking a statin for cholesterol issues avoid having a heart attack—thus avoiding the employer's associated cost for a Short Term Disability claim, the hospital room charge, and possibly more medications post event? Perhaps the return on investment on the drug spend is irrelevant, and the cost of the benefits is really just part of compensation?

To parody the Farmer's Almanac, the forecast on presciption drug costs might read, "costs increasing across the country, regional difference influenced by legislated events, flash high cost medications should be expected, little change in underlying health conditions." Sustainability of employers' prescription drug plans is once again being talked about. The cost relief—enjoyed through price decreases from brand medications losing patent protection and provincial governments mandating their cost reductions would also apply to private payers—is over. More and more chronic disease medications are being taken by an increaseing number of people. High cost specialty drugs are growing in applications, and pharmaceutical companies are working on even more. Finally, the risk of the public system down loading services and shifting costs to the private and public employer EHC plans should not be discounted.

If the current cost of the prescription drug spend has caught your attention already, keep watching the radar.

Notes

↵1. *Are we spending too much too little or just enough on prescription drugs?* Laureen Rance, BSc Pharm, Pharm D MSc; February 11, 2014; Telus Health Annual Drug Conference

↵2. *Green Shield Canada Drug, Health & Dental Insights*, September 2013

↵3. *Green Shield Canada Drug, Health & Dental Insights*, September 2013

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Become a Reviewer for the Canadian Award for Financial Reporting

What is the Canadian Award for Financial Reporting Program? The Government Finance Officers Association's Canadian Award for Financial Reporting Program (CAnFR Program) has been promoting the preparation of high quality financial reports since 1986. More than 60 governments participate in the program each year. All participants are Canadian municipal governments that follow the standards promulgated by the Public Sector Accounting Board.

Volunteer to Serve as a Reviewer

If you are an accountant, auditor, or academic with experience in governmental accounting and financial reporting, you are invited to become a volunteer reviewer for the Canadian Award for Financial Reporting Program.

What are the benefits of serving as a volunteer reviewer?

Volunteer reviewers can:

- Be at the forefront of the most recent changes in accounting and financial reporting for local governments,
- Get exposure to a variety of reports from around the country,
- Access a practical way of providing training and development for junior staff without an incremental cost,
- Gain insight into how to improve their own annual financial reports, and
- Achieve professional recognition.

How much time does it take to serve as a reviewer? Reviewers enjoy considerable flexibility regarding the number and type of reports they wish to review. The GFOA has developed a checklist to streamline reviews and save valuable time. The reviewer's checklist is available at the GFOA's website in the CAnFR Program section. GFOA staff is available during normal business hours to answer questions you may have during the review process.

What are the requirements for serving as a reviewer? An individual does not have to be upper management or have significant experience with external financial reporting to serve as a reviewer. The GFOA encourages those with any experience in local government accounting and financial reporting to join in the review process. You are encouraged to use your time as a reviewer as a tool for professional development and educational purposes. In order to become a reviewer, one should possess a solid understanding of GAAP as established by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants.

For more information on the CAnFR Program, visit the CAnFR Program page on GFOA's website. To become a CAnFR Reviewer, complete the Reviewer's Application Form and forward it to Jim Phillips at CAnFR@gfoa.org. Any questions about the program or becoming a reviewer can also be addressed to Jim Phillips.

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2015 GFOAWC Annual Conference

The Government Finance Officers Association of Western Canada's annual conference will be held at the Westmark Hotel in Whitehorse from September 14th to 16th. Delegates will be able to register soon. For more information, visit the GFOAWC's website.

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2015 GFOA Annual Conference

Register early and save!

If you're not yet signed up to attend GFOA's 109th annual conference, *Innovation and Resilience*, on May 31–June 3 at the Philadelphia Convention Center in Philadelphia, Pennsylvania, sign up by **February 17** to take advantage of the early registration fee. Click here to view the brochure, register, and reserve your housing online through **GFOA's official hotel block.**

As part of the conference, once again a Canadian-specific session will be held that will focus on one of the key topics currently impacting Canadian government finance officers. A Canadian Update will also cover a wide range of informative topics and to provide delegates the opportunity to share information with members of GFOA's Standing Committee on Canadian Issues.

Earn additional CPE credits by signing up for GFOA's preconference seminars on Friday, 29, and Saturday, May 30, at the Pennsylvania Convention Center. Click here for seminar descriptions and to register.

Questions? E-mail conference@gfoa.org.

Save the Date: The GFOA's 110th annual conference will take place on May 22-25, 2016, at the Metro Toronto Convention Centre.

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Scholarships

The GFOA currently offers three annual scholarship programs to students enrolled in full-time courses of study preparing for careers in state, provincial, and local governments, and one annual scholarship program to employees of a state, provincial, or local government enrolled in part-time graduate study preparing for a career in state, provincial, or local government finance. For more information about these scholarships, please visit GFOA's Scholarship Page. Please note, applications must be postmarked by **February 20, 2015**, to be considered, and recipients of the scholarships will be announced by April 30.

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