
C.D. Howe Institute Report – Building Better Budgets

Recommendation

That the information be received.

Topic and Purpose

The purpose of this report is to examine the recommendations proposed by the C.D. Howe Institute on Building Better Budgets and how they apply to the City of Saskatoon (City).

Report Highlights

1. The C.D. Howe Institute issued its annual report on Building Better Budgets which focuses on four recommendations: gross based budgeting, approving budgets in a timely manner, accrual budgeting, and reconciliation between budgets to annual reports.
2. The City currently budgets and reports on a gross basis in order to promote fiscal transparency by outlining the total costs of programs.
3. Since 2011, the City has approved operating and capital budgets prior to January 1 each year.
4. Cash base budgeting provides more options, flexibility and better financial management than accrual based budgeting.
5. The City provides numerous reports throughout the year which outline budgetary performance.

Strategic Goal

This report supports the Strategic Goal of Asset and Financial Sustainability by being open, accountable and transparent, particularly when it comes to the resource allocation and collection decisions the City makes.

Background

As required by *The Cities Act*, City Council is required to authorize annual budgets and financial statements on a yearly basis. The annual budget has historically been prepared on the cash basis of accounting, while the financial statements are on an accrual basis of accounting.

Report

C.D. Howe Institute Report

In November 2015, the C.D. Howe Institute (C.D. Howe) released its annual report entitled “Building Better Budgets: Canada’s Cities Should Clean Up their Financial Reporting” (Attachment 1). The report focuses on the need for Canadian cities to revise

their budgets and financial reports so City Councillors and ordinary citizens can make sense of them.

There are four recommendations for improving municipal budgets:

1. Budget documents should report operating expenditures on a gross basis.
2. Budgets should be approved in a timely manner.
3. Budgets and capital financing should be on an accrual basis.
4. A reconciliation between budgets and financial statements should be completed.

Gross Basis Budget

C.D. Howe recommends that budget documents clearly show the total gross cost of a municipal service as opposed to netting it against operating revenues. Some municipalities will net expenses against operating revenues in the annual budget document in order to show the “tax supported” portion of a program or service.

C.D. Howe states that by not showing the total gross cost of a program or service, municipalities are understating a government’s fiscal footprint.

The Administration agrees with this recommendation in that gross reporting shows the total cost of a program or service. The City’s operating budget currently identifies expenses and revenues under each service line for the current budget year.

Budgets Approved in a Timely Manner

C.D. Howe and the Administration agree that budgets should be approved in a timely manner prior to the budget year. Since 2011, the City has approved the annual operating and capital budgets prior to January 1 in order to authorize all expenditures and service levels for the upcoming year. This is important to ensure that expenditure and service levels are in accordance with the approved Business Plan and Budget, and that there is no period where the Administration is operating without parameters.

Budgets on an Accrual Basis

Currently, most city budgets are prepared on a cash basis and the annual report is prepared on an accrual basis. For most provinces, including Saskatchewan, this is a legislative requirement. C.D. Howe recommends that municipalities should budget on an accrual basis in order to be consistent with the annual report.

The primary difference between accrual and cash basis accounting is the timing of when revenue and expenses are recognized. The cash method which is used for budgeting recognizes all money that is to be received in a given year and only expenses which money is expected to be paid out. The accrual method accounts for revenue when it is earned and expenses when goods or services are incurred.

The largest difference for a municipality would be in terms of capital financing. For example, if the City were planning to purchase an asset worth \$1 million with a useful life of 10 years under cash based budgeting, \$1 million would be recognized as a capital expense in the year of purchase. Under accrual based budgeting, expenses would not be recognized until the value of the asset is being utilized (known as depreciation)

which means \$100,000 (\$1 million/10 years) per year. The issue arises in terms of financing.

Under cash basis budgeting, the City would fund an investment of \$1 million in the years leading up to the purchase to pay for the capital outlay. Under accrual budgeting, the City would not be able to generate funds to pay for the asset until it is being utilized, which means \$100,000/year for each of the 10 years it is owned. Under accrual based budgeting, the City would have \$0 available at the time of purchase and would need to incur additional debt to cover the purchase and generate funds as value is derived from the asset to pay it off.

To provide perspective, the City had cumulative capital budgets of \$2.284 billion from 2008 to 2014 which was funded from a variety of sources. Under accrual budgeting, funding would be limited to depreciation which was \$565.2 million over the same time period. For comparison sake, if accrual budgeting was utilized during this period, the City would have required an additional \$1.719 billion in debt financing to complete the same amount of capital from 2008 to 2014. This is a fundamental problem with accrual based budgeting as in years when capital budgets are larger than the annual depreciation charge, municipalities are required to take on additional debt. The City's current and past practice has focused on a "pay-as-you-go" method by raising required funds prior to the capital outlay in an effort to minimize unnecessary debt.

In addition, C.D. Howe suggests that under cash based budgeting, cities have potentially been collecting more funds than necessary. As shown in Table 3 (page 3 of the Building Better Budgets report), Saskatoon is shown as posting \$1.431 billion worth of surpluses from 2008 to 2014 under accrual based reporting. While annual reports do list a cumulative \$1.431 billion surplus from 2008 to 2014, this is largely due to capital purchases as indicated by the \$2.284 billion worth of approvals from 2008 to 2014 which are not reflected in the annual report as an expenditure.

Overall, the Administration is confident that budgeting on a cash basis provides more flexibility, options to City Council, and better financial management than accrual based budgeting. The City's current method allows for adjustments and funding for future commitments as identified in the City's various funding plans instead of limiting funding capabilities to historical cost. This is supported by the recent Standard & Poor's AAA credit rating report which stated, "The ratings on the City of Saskatoon, in the Province of Saskatchewan, reflect Standard & Poor's Ratings Services' opinion of the city's very strong economy, budgetary flexibility and budgetary performance, and exceptional liquidity levels."

A budget is a planning tool and would not be useful if adjusted to meet theoretical reporting objectives that do not seem to provide a great benefit.

Reconciliation between Budget and Financial Statements

C.D. Howe recommends that reconciliation should be provided in the annual report in order to compare how the audited final results compared to budget. The City does not prepare this reconciliation due to the fundamental differences between the annual report

and budget. However, performance compared to budget is communicated through several other reports, such as:

- quarterly reports to City Council which provides updates on budget performance and projected surpluses/deficits; and
- the annual year-end report to City Council which outlines budget performance and provides an overview of budget to actual results on a cash basis.

Public and/or Stakeholder Involvement

The Administration has communicated with other Canadian municipalities through its membership on the Committee of Canadian Issues of the Government Finance Officers Association. There is a consensus of that Committee that the conclusions are similar to those identified in the report. The Administration also discussed these point with representatives from the North Saskatoon Business Association.

Due Date for Follow-up and/or Project Completion

A due date for follow-up and/or project completion is not required.

Public Notice

Public Notice pursuant to Section 3 of Policy No. C01-021, Public Notice Policy, is not required.

Attachment

1. C.D. Howe Institute – Building Better Budgets: Canada’s Cities Should Clean Up their Financial Reporting

Report Approval

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