HALDIMAND COUNTY

Report FIN-16-2019 Audited Financial Statements for 2018

For Consideration by Council on November 4, 2019

OBJECTIVE:

To present the audited 2018 Consolidated Financial Statements (including the Trust Fund statements) and details of the Operating Surplus/(Deficit) position for Haldimand County for the year ended December 31, 2018.

RECOMMENDATIONS:

1. THAT Report FIN-16-2019 Audited Financial Statements for 2018 be received;
2. AND THAT the consolidated financial statements, including the Trust Fund Statements, for Haldimand County for 2018, as audited by Millard, Rouse and Rosebrugh LLP, be received and approved.

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Reviewed by: Charmaine Corlis, Treasurer

Respectfully submitted: Mark Merritt, CPA, CA, General Manager of Financial & Data Services

Approved: Craig Manley, MCIP, RPP, Chief Administrative Officer

EXECUTIVE SUMMARY:

Highlights from the 2018 audited financial statements (presented under separate cover) are as follows:

- **Investment Portfolio:** As outlined in the annual investment report to Council in June 2019, the carrying book value of the County's investment portfolio was approximately $152.0 million compared to a book value of $166.7 million at December 31, 2017. This decrease is mainly due to unfinanced capital projects for which the issuance of debt occurred in 2019 (approximately $32.7 million in debt was issued in 2019 for active projects). The 2018 year end book value is comprised of approximately $60.0 million in fixed income investments, while the 2018 growth/equity year end book value remain equivalent to 2017 year end of $92.0 million. This portfolio, coupled with strong annual returns has led to increased liquidity, revenue and financial flexibility.
- **Substantial Investment in Infrastructure:** The County invested over $40 million in infrastructure (replacement and new). This significant investment is outpacing the use of current assets, and is a result of needed facility replacements, some growth, and acceleration and enhancement to roads. Prior years have ranged anywhere from $25 million to $37 million. At the end of 2018, the historical cost of the County's infrastructure was estimated at approximately $884 million.
- **Reserves/Reserve Funds:** The County has established numerous reserves/reserve funds to ensure sufficient funds are available for future expenditures. Total Operating and Capital Reserves/Reserve Funds, at December 31, 2018, were $81.7 million which represents a decrease of approximately $480,388 over the previous year. This excludes both our Hydro

legacy fund of $79.9 million, which increased $2.4 million over 2017, as well as our Community vibrancy fund which has a negative balance of almost $11 million.

- **Reduction in Net Long Term Debt:** Despite significant investment in infrastructure, the County's net long term debt decreased by $5.2 million in 2018 to a year end balance of $42.5 million. However, the County has almost $14 million of unfinanced capital costs at the end of 2018 – an increase of $12 million over the previous year. These costs are primarily due to the Dunnville Wastewater Treatment Plant, Haldimand County Administration Building and Cayuga Library projects that were funded through the 2019 debt issuance.
- **Strong Credit Rating**: The above noted items were several of the factors noted during the County's annual credit rating review in 2019. The County's credit rating was affirmed at "AA/Stable" by the independent bond rating agency of Standards & Poor's Rating Services; primarily based on exceptional liquidity, strong and flexible budgetary performance and minimal debt burden. These estimates were based on assumptions that capital expenditures would remain close to $35 million.

The audited 2018 surplus/(deficits) for Haldimand County financial operations are presented in this report, together with reasons for the significant variances from the Council approved budgets.

The net surplus for the three main functional areas is transferred to/from the appropriate reserve in accordance with previously approved Council resolutions.

Audited 2018 Operating Net Surplus/(Deficit)		
Tax Supported Operations		**$1,613,910**
Rate Supported Operations		
Water Operations	$864,209	
Wastewater Operations	$581,407	**$1,445,616**
Total Operating Surplus		**$3,059,526**

The presentation of the 2018 audited financial statements, albeit a part of transparent and accountable fiscal management, fulfills the Corporation's statutory obligations to present annual audited financial statements to Council and the public. These statements, as well as the attached Building Division and Parkland Dedication Reserve Fund Statement of Activities, will be posted on the County's website for public access by local taxpayers and ratepayers.

BACKGROUND:

The Municipal Act, 2001 (the Act) provides that the auditor appointed by the municipality shall annually audit the accounts and transactions of the municipality, express an opinion on the financial statements and report to Council. The external auditor's responsibility is to express an independent opinion on the financial statements, based on audit evidence, as to whether the statements present fairly, in all material respects, the financial information contained therein. Audit practices and procedures are based on the following principles: the users (or readers) of the statements are "reasonable users"; auditor's evaluation of risks of misstatement is based on internal controls/inherent risk of misstatement; professional judgment; and sufficient audit evidence to support their opinion.

Management is responsible for the preparation and fair presentation of the annual statements in accordance with Canadian Public Sector Accounting Board (PSAB) accounting standards. As a result, management is responsible to ensure there are adequate internal controls so that financial reporting is accurate and free of misstatements. The auditors will use management's established controls and processes to determine the level of audit evidence they must obtain to issue their opinion on the municipality's statements.

In an effort to move to a full accrual basis of accounting, PSAB adopted Handbook Section 3150, Tangible Capital Assets, and its associated reporting requirements. The implementation of this section, effective January 1, 2009, requires municipalities to report tangible capital assets in the statement of financial position. In addition, the amortization of tangible capital assets is to be accounted for as an expense in the statement of operations. Ultimately, these reporting requirements changed how municipalities report capital assets and the financial resources necessary, or lack thereof, to fund these requirements.

Even prior to these more recent amendments, there have always been reporting differences between the annual budgets, internal financial reporting and the audited financial statements. Although the intent of the latest PSAB amendments is to better align the municipality's annual reporting with full accrual accounting, most municipalities have maintained their previous internal reporting and budget formats. The rationale for some of these differences is that a municipality's budget is focused on long range financing principles and manageable impacts on rates and taxpayers over these periods. As a result, differences in financial reporting and funding of certain liabilities and costs are likely to persist into the future (e.g. amortization of existing assets may not provide a good basis for determining future funding requirements to replace the existing assets).

Similar to most Provincial municipalities, the County has adopted a process to convert the internal statements to PSAB compliant financial statements for auditing purposes (as detailed in Table 2 below). The County traditionally segregates its operational financial results into three main areas: tax supported operations, water operations and wastewater operations (these last two areas are independently financed – water costs from water users and wastewater costs from wastewater users). Capital operations are considered a work-in-progress until projects are complete and each project has specific, Council approved funding. It should also be noted that any capital variances are excluded from the analysis presented in this staff report (as they are reported on separately during the year). Reserve and reserve fund operations represent the net transfers to and from reserves or reserve funds during the year.

Typically, staff present the operational financial results to Council on three separate occasions during a fiscal year. These are segregated primarily between tax supported and rate supported operations (with sub-categories identified in each category). Reporting timeframes are as follows:

- In-year results: This report is presented to Council based on year to date financial results and reflects the annual projections for expenditures and revenues to year end (taking into account the year to date operations). This report is typically presented to Council in late summer or early fall.
- Draft Budget: In the respective draft operating budget (i.e. tax supported and rate supported water and wastewater), the projected previous year end financial results are reported. Included in the Treasurer's Report is an explanation of any significant anticipated variances and the impact, if any, on the draft operating budgets.
- As part of the audited financial statements: actual surpluses and deficits are identified and major drivers are summarized.

The focus of this staff report, independent of the auditor's report, is to:

- Summarize the required adjustments to meet PSAB reporting requirements, as they are reflected in the accompanying audited financial statements; and
- Summarize key components of the <u>audited</u> surplus or deficit for the year (for internal reporting purposes, operational surpluses or deficits are transferred to/from specifically identified reserves).

ANALYSIS:

The County's auditor, Millard, Rouse & Rosebrugh LLP, has recently completed their audit of the 2018 Consolidated Financial Statements. The audited statements are provided as Attachment 3 to this report and will be presented by the auditor at the November 4th Council meeting. These statements also include the annual results of the County administered Trust Funds (i.e. cemetery perpetual care funds, Grandview Lodge bequest funds and Grandview Lodge Comfort Trust fund).

As outlined above, under the PSAB principles, the move to full accrual accounting required dramatic changes to past methods of reporting certain transactions. Most notable is the requirement to report tangible capital assets on the Statement of Financial Position (i.e. balance sheet) and amortize these capital costs over their useful life. Prior to 2009, these costs were expensed on a cash basis in the year they were acquired or constructed, rather than depreciated over time.

Reconciliation of Budget and 2018 Operating "Surplus"

To date, Ontario municipalities have not been legislated to amend their annual budget formats to reflect the accrual accounting method for tangible capital assets. As a result, the format of the annual budget does not match the audited financial statement presentation, making it somewhat difficult for Council and the public to reconcile these critical financial reports. Municipalities have expressed significant concern to the Province of Ontario that, although supportive of the reasons for recording asset values in the financial statements, the legislated budgeting methodologies are currently incompatible with the PSAB approach (for example, municipalities must have balanced budgets), resulting in significant public confusion. In particular, the reporting of budget variances (surpluses/deficits) will cause confusion because of the timing of financial transactions based on cash accounting (traditional approach) versus accrual accounting (PSAB approach). In other words, municipalities traditionally do not budget for amortization of the acquisition, utilization or disposal of assets based on the useful life but, instead, based on actual timing of the cash transactions associated with each of those activities. For comparison purposes, the budgets included in the Financial Statements include a budget for amortization based on the actuals.

Under PSAB reporting requirements, reserve and reserve funds form an integral part of the County's accumulated surplus and, as such, do not appear as a separate schedule within the financial statements. Correspondingly, any contributions to or from these reserves and reserve funds must be removed. Principal debt repayments are removed as these payments reflect a reduction in a long term liability. All the above noted adjustments represent "financing" requirements which are integral to any municipality's long range funding plan.

The following table outlines the adjustments required and the resulting amended "budget" to be reflected in the audited financial statements for 2018.

TABLE 1

Description	2018 Impact
Surplus for year per approved Budgets (*)	$0
Add:	
Capital expenditures to be capitalized	$35,224,210
Budgeted transfers to accumulated surplus (i.e. contributions to reserves/reserve funds)	$29,161,420
Principal payments on debt	$5,187,760
Less:	
Budgeted transfers from accumulated surplus (i.e. use of reserves/reserve funds)	($41,215,225)
Amortization	($24,121,621)
Revised budgeted surplus as reported on audited Financial Statements	**$4,236,544**

(*) – includes both tax supported and rate supported operating and capital budgets.

As shown above, most of the PSAB related budget adjustments relate to capital transactions, including expenditures, reserve transactions and debt financing. The net effect of these adjustments results in a budgeted "surplus" due, primarily, to the construction of new capital assets. Since the majority of the County's financing of capital related transactions is from specific reserves and reserve funds, these amounts must be removed or added back, as applicable, for financial statement presentation purposes. This is due to the PSAB requirement to amortize capital assets on the statement of operations (i.e. income statement). For 2018, budgeted expenditures related to amortization has been added (equal to actual amortization) to eliminate large variances related to amortization for the year (which has been an issue in previous years when reviewing actual results compared to budgets).

As outlined during the review of the 2018 Tax Supported Operating Budget, certain annual expenditures are not required to be budgeted for, as follows: amortization expenses related to capital assets; post-employment benefit costs; and solid waste landfill closure and post-closure expenses. This factor, combined with the required presentation of capital assets in the financial statements (as noted in Table 1), makes it challenging to reconcile the reporting of operational results under the traditional format presented in the annual operating budget, as compared to the current PSAB format.

Table 3, presented later in this report, identifies an overall net operating surplus for the 2018 fiscal year of approximately $3 million. This reflects the financial results for tax and rate supported operations – which excludes capital and reserve/reserve fund operations. In comparison, the PSAB compliant reported surplus on the 2018 audited financial statements is approximately $7.3 million. The following table reconciles the reasons for the differences in how the surplus/deficit has been reported:

TABLE 2

Description	***Impact on 2018 Surplus Increase/(Decrease)***
Revenue Fund – surplus from 2018 tax supported and water/wastewater operations (details analyzed in Table 3)	$3,059,526
***Add Net Capital and Reserve Fund Operations*:**	
Capital Fund (work in progress to be funded – primarily from debt)	(11,880,904)
Reserves/Reserve Funds (net transfers)	(3,086,618)
Sub-total per Internal Financial Statements	(11,907,996)
***Adjustments for PSAB Audited Financial Statements*:**	
Principal debt repayments	5,187,727
Debt Proceeds	-
Business Improvement Areas (2018 net operations)	(40,687)
Decrease/ (Increase) in landfill post-closure liability	(95,476)
Capital costs capitalized (i.e. not expensed) during the year	27,349,455
Capital costs included in work in progress (i.e. not complete as at December 31st)	12,792,353
Amortization of capital assets	(24,121,621)
Net costs associated with disposal of capital assets	(1,118,355)
Change in post employment and sick leave liabilities	(88,700)
Change in workers' compensation liabilities	(3,380,312)
Change in deferred revenues/obligatory reserves	2,740,100
2018 Surplus Reported on Audited Financial Statements	**$7,316,488**

Consistent with the adjustments for the approved budget as outlined in Table 1, the above differences between the revenue fund operating surplus and the audited financial statements relate primarily to capital transactions that are not expensed for PSAB reporting purposes or capital revenue sources not budgeted for on an annual basis. In addition adjustments for accrual of post employment benefits and WSIB liability are not reflected in annual budgets (these costs are budgeted based on actual cost to be incurred in the year or estimated liability based on current costs). Some of the more significant 2018 operating variances are as follows:

- Operating Revenues: The total variance between actual revenues compared to budgeted revenues is approximately $10.1 million favourable variance. The main contributing factors to the reported variance is related to:
    - Developer Contributed Assets: during 2018 several subdivisions were developed to the point that the County assumed significant infrastructure totaling approximately $3.8 million. The value of these contributed assets, although built and paid for by the development, is recorded as revenue upon assumption by the County. As the timing and value of these assumed assets can vary significantly, year over year, these revenues are not typically budgeted by municipalities and as such are reported as a variance.
    - Development Charges Recognized: Since development charges collected on an annual basis are used directly for specifically identified growth related capital projects, these revenues can only be recognized/reported as income in the years the related project is constructed. Due to the timing and magnitude of the projects, the development charge revenue recognized on an annual basis can fluctuate considerably. As these revenues are recorded in the County's books as reserve funds, there is no annual budget

established. In 2018, revenues of <u>$3.7 million</u> were recognized, related to the matching 2018 growth related capital project expenditure, resulting in a favourable variance.

    - Federal Government Transfers: The majority of the Federal Government grants relate to infrastructure funding, the largest portion being the annual Federal Gas tax allocation. The County receives approximately $2.9 million annually, however for PSAB reporting purposes, only the funds used on specifically identified capital projects can be recognized in the same fiscal period. As a result, depending on the projects selected and the timing of the costs associated with these projects, the amounts recognized in any given year can fluctuate. As such, <u>$3.8 million</u> was utilized and recognized in 2018 versus the budgeted amount of the $2.9, resulting in a favourable variance of $939,000.
    - Provincial Government Transfers: Provincial infrastructure funding is related to the Ontario Community Infrastructure Fund. Although $1.7 million was budgeted in 2018, only the funds used on specifically identified capital projects can be recognized in the same fiscal period. As a result, depending on the projects selected and the timing of the costs associated with these projects, the amounts recognized in any given year can fluctuate. For 2018, <u>$2.5 million</u> was utilized, resulting in a favourable variance of $814,000.

- Operating Expenditures: The total variance between actual expenditures compared to budget is approximately $7 million unfavourable. One of the main contributing factors to the reported variance is due to non-capitalized capital expenditures which do not meet the thresholds/established parameters to be recorded on the balance sheet as tangible capital assets. A total of $7.8 million net costs were expensed in 2018 with no corresponding budget identified (the full budgeted value of the capital expenditures was removed and assumed to meet PSAB reporting requirements to be capitalized and recorded on the balance sheet). The major area impacted is Transportation Services which had $7.8 million expensed related to projects that did not meet the criteria to be capitalized. As an example, the surface treatment program is not capitalized of which the Cheapside Road project alone was $1.2 million.

It should also be noted that, since under PSAB's technical reporting guidelines there are no "reserves/reserve funds", the balance in these reserves/reserve funds forms part of the County's overall "accumulated surplus" as denoted in Note 11 of the audited financial statements.

Staff acknowledge that the above reporting of the annual "surplus" is confusing. **It must be emphasized that the PSAB reported net 2018 surplus of $7.3 million is a book value adjustment, not a "cash" surplus**. Although the Province initiated a review in 2014 to evaluate the current disparities between internal reporting/budgeting and current PSAB annual reporting requirements, the overwhelming response from municipal representatives was to leave the current reporting requirements as is. It was also acknowledged that simpler methods of reconciling the differences and reporting to the public need to be developed to foster a better understanding of the municipality's financial position and key financial components. This will be an evolving process with best practices and feedback from users of the financial statements leading the way.

<u>Analysis of 2018 Net Operating Surplus/(Deficit)</u>

The table below provides a breakdown of the audited 2018 operating surplus (the "cash" surplus) by major function. In accordance with previous resolutions of Council, the net surplus/(deficit) from the operational areas denoted below are contributed to or transferred from various Reserves/Reserve Funds.

TABLE 3

Audited 2018 Operating Surplus/(Deficit)		
(a)	Tax Supported Operations – General	$1,106,217
	Public Health (included as part of transfer to Contingency Reserve)	$227,438
	Social Assistance/Child Care	$148,426
	Social Housing	$235,467
	Library	$98,919
	Investment Income (net of stabilization transfer)	($202,557)
	Sub-Total – Tax Supported Operations	**$1,613,910**
(b)	Water Operations	$864,209
	Wastewater Operations	$581,407
	Sub-Total – Rate Supported Operations	**$1,445,616**
	Total Operating Surplus/(Deficit)	**$3,059,526**

The total 2018 operating expenditures (combined tax supported and rate supported) were budgeted at approximately $130.2 million. The above noted net operating surplus of $3,059,526 represents a 2.3% positive variance in relation to Council's approved budgeted expenditures. As these operations/funds have significantly different revenue sources and expenditure drivers, details of the significant variances in the individual areas/functions are provided below.

(a) Tax Supported Operations

Overall, the Tax Supported Operations reflect a 2018 surplus of approximately $1,600,000. This net surplus represents a **1.5%** favourable variance on approximately $109.2 million of budgeted 2018 tax supported operating expenditures. This surplus is not significant in relation to total budgeted expenditures or acceptable municipal financial standards. The annual tax supported operational surplus has traditionally been approximately 1.0% and has been positive and negative over the past five years.

Based on previous Council approval, any annual surplus/(deficit) is transferred to or from the applicable reserves, annual variances will impact the associated balances of these reserves but have no direct impact on the following year's tax levy. With respect to the general tax supported operations, a net surplus of $1,106,217 was transferred to the Contingency Reserve, which has a balance of approximately $12.2 Million at the end of 2018 (including of the above noted surplus). Although there are no set guidelines, a typical rule of thumb is 10% of tax supported operating costs. This would require, at a minimum, a balance of $11 million. This reserve will be available for future years as a source of financing for unexpected events/liabilities. Any excess funds can be reallocated by a future Council for another one-time municipal purpose if so warranted.

The surplus is the net result of several favourable and unfavourable financial impacts on operations during the year. Significant items contributing to the overall surplus from Tax Supported Operations are detailed below.

TABLE 4

2018 Operating Variance Analysis for Tax Supported Operations	
Revenues	**Surplus/(Deficit)**
Provincial Transitional Mitigation Grant (to offset lost property taxation from two long term care facilities change in tax status to exempt in 2016)	183,327
Engineering/Inspection Fees & Planning Fees based on timing of development activity	(156,769)
One time recoveries - HST recovery from review of solid waste transfer operations	123,688
Arena revenues	(50,190)
Penalty & Interest - Taxes	(114,518)
POA Fines Revenue	41,472
Supplementary Taxes - mainly due to residential development	1,127,003
Payment in Lieu of Taxes due to increased assessment	48,473
Grandview Lodge revenues	57,952
Interest on Investments	(100,000)
Subtotal Revenues	**1,160,439**
Expenditures	
Salaries/Wages & Benefits - Including Meeting, Travel and Professional Development - Mainly due to gapping, i.e. unfilled vacancies - County wide (2.6% of total salaries & wages budget)	1,030,352
General Operating Supplies - Corporate wide (individually under $40,000)	72,138
Fleet operations fuel, supplies and services	(175,588)
Property tax adjustments (tax appeals and vacancy rebates)	(223,203)
Solid Waste Deficit - due to higher than anticipated leachate volumes partially offset by cost sharing with Norfolk County; Haldimand share of deficit partially offset by additional tipping fee revenues and higher than budgeted blue box commodity revenues	(46,302)
Snow Removal for Corporate facilities	(70,015)
Roads Maintenance supplies and services due to additional work, and additional streetlight maintenance	(180,521)
Winter Control Supplies and Contracted Services	(568,771)
Hydro - Savings primarily in Streetlights ($42K); Savings in Grandview ($64K) mainly due to lighting retrofit; Deficit in Arenas mainly due to timing of retrofit project ($18K)	205,810
Miscellaneous net items (individually under $40,000)	(98,122)
Public Health	227,438
Social Assistance/Child Care	148,426
Social Housing	235,467
Library Operations	98,919
Investment Income Stabilization Reserve Funding	(202,557)
Subtotal Expenditures	**453,471**
Net Tax Supported Operations Surplus	**$1,613,910**

Note: Above table excludes items that net to $0 levy impact (e.g. additional revenues offset by transfers to reserves or additional costs).

The majority of the net surplus for the year is made up of only a handful of items, albeit representing significant dollars. Explanations for the major areas (not already detailed above) from Table 4 are as follows:

Supplementary Taxes

Although there was a surplus in supplementary taxes (new construction) in both 2018 and 2017, in previous years, the supplementary taxes budget was challenging to meet. As growth within the County is expected to continue for several years, the 2019 tax supported operating budget was increased by \$300,000 to \$900,000. Further review is recommended to monitor this increased assessment related to development throughout Haldimand County.

Interest on Investments

As identified in the annual investment report (FIN-10-2019) presented to Council in June of 2019, the overall investment income reported within the Financial Statements is approximately \$2.7 million representing a 3.79% realized gained. Noted in the report, due to the allocation mix, where much of the investment income is allocated to various reserve funds, there is a deficit related to the tax supported operations. According to the investment policy, \$202,557 was funded from the Investment Income Stabilization Reserve, and \$100,000 deficit was applied to general operations. It is anticipated that the funds utilized from the Investment Income Stabilization Reserve will be recovered from future realized gains as currently held investments mature or are liquidated.

Salaries/Benefits and related costs (net surplus of \$1,030,352) – Net surplus is approximately 2.6% of the total annual salary and benefit budget (which includes salaries, benefits, overtime, professional association dues, staff meetings, travel and professional development) of approximately \$39.2 million. As the budget is prepared based on a full staff complement on an annualized basis, any staff vacancies will result in “gapping savings” that typically more than offset unanticipated compensation adjustments or recruitment costs to fill these positions. As well, meeting expenses, travel, and professional development accounts experienced surpluses mainly driven by the same position gapping. These savings also incorporate unbudgeted costs associated with post employment benefits for retirees.

Winter Control costs, including supplies, services and snow removal (net deficit of \$566,707): The frequency, timing and severity of the weather events can significantly impact the operational budget (primarily in the areas of sand/salt purchases or contracted snow plowing services). Council was advised late fall 2018 of the deficit and again during budget deliberations for 2019. The final net deficit for 2018 is a result of salt/sand purchases being over budget by \$149,486 and contracted snow plowing and snow removal over budget by \$419,285. As experienced with the varying winter conditions of past years, winter control costs can fluctuate significantly from year to year. The 2019 Tax Supported Operating Budget included a \$120,000 increase related to winter control supplies and services. Continued refinement of winter control budgeting will be required to assess the appropriate annual funding necessary to meet the legislated and Council approved winter control service levels. Staff also continue to look at methods to reduce the County’s winter control costs, such as the salt management program and alternative control materials, to offset a portion of the historical annual deficits associated with the purchase of these supplies.

Shared Services with Norfolk County (net surplus of \$611,331): Norfolk County is the Consolidated Municipal Service Manager (CMSM) for legislated social services, as well as the Board of Health and provider of legislated public health services for both Norfolk and Haldimand Counties. Norfolk County bills Haldimand County on a monthly basis for the estimated costs of services attributed to Haldimand County (based on the principles of a previous arbitration award). Once the actual costs for the year are determined, a reconciliation is completed and any surplus/deficits are determined. Based on a reconciliation of actual results for the year 2018 a total surplus of \$611,331 was recognized as follows: Public Health \$227,438 (mainly due to gapping), Social Services/Child Care \$148,426 and Social

Housing $235,467. Staff have been working closely with Norfolk staff over the past years to expedite the reconciliation process, as well as clean up several outstanding amounts due to/from the two municipalities. As a result, this reconciliation reflects the 2018 year only, as previous years were reconciled with the 2017 financial statements.

<u>Building Division Operations (net deficit of $299,971) offset by transfer from Building Permit Stabilization Reserve Fund</u>: Building Division net operating results are required, by legislation that has been in place since 2005, to be transferred to/from the County's Building Permit Stabilization Reserve Fund. As noted in March during the Community and Development Services 2018 Annual Report, building permit revenue was down significantly from 2017. This has resulted in a deficit of $299,971 funded from the reserve fund. This reserve fund has a balance of approximately $5.1 million as at December 31, 2018. As a result, the net impact on the 2018 tax supported operations is $0 in keeping with the legislative requirements (the budget is also approved at a net $0). The overall fee structure was reviewed and amended during 2018, and as a result, the current surplus within the reserve fund was taken into account, in order to mitigate excessive surplus funds, and ensure fluctuations within annual costs could be accommodated. Included in Attachment #1 are the historical operations of the Building Division affecting the balance of this reserve fund. This statement is required to be produced annually and will be released in conjunction with the annual audited financial statements.

(c) Water and Wastewater Operations

The combined 2018 Water and Wastewater Operations net surplus is approximately $<u>1,446,000</u> on total budgeted operating expenditures of $21 million. This represents a positive variance of 6.9%. However, as the water systems are self funded specifically from the direct users of that system, as are the wastewater systems (which in some cases are not the same users), the variance must be further segregated between water and wastewater operations.

The 2018 water operations reflected a $864,209 surplus on budgeted expenditures of approximately $12.3 million (7.0%), and wastewater operations had a surplus of $581,407 on budgeted expenditures of approximately $8.7 million (6.7%). A further breakdown of the significant variances is provided as follows (Table 5 for Water and Table 6 for Wastewater.)

TABLE 5

2018 Operating Variance Analysis for Rate Supported Operations - WATER	
Revenues:	**Surplus/ (Deficit)**
Residential User Rates Revenue - Basic and Consumption	179,761
Commercial/Industrial User Rates - Basic and Consumption (large industrial users)	231,264
Recoveries from New Credit (residential and bulk water increased consumption)	93,011
Bulk Water Sales (mainly due to Jarvis and Hagersville)	86,696
Water Meter Installations (projections amended in 2019 budget)	(45,846)
Nanticoke Industrial Pumping Station - Stelco and Imperial Oil recoveries (offset by expenditures below)	(9,066)
Port Maitland Raw Water (offset by expenditures below)	(245,247)
Miscellaneous Fees & Recoveries (individually under $25,000)	11,359
Sub-total Revenues	***301,933***
Expenditures:	
-	
Salaries & Wages (shift in distributed wages based on additional hours allocated to wastewater operations; partially offset by gapping - total surplus of $37,600)	71,789
Hamilton Water Supply - Wholesale Water Purchases	233,877
Billing and Collecting Costs	32,976
Hydro (County share)	63,439
Nanticoke Industrial Pumping Station - Stelco and Imperial Oil share of expenditures - mainly hydro savings (offset by recoveries above)	9,066
Port Maitland Raw Water - mainly due to less reserve fund requirements (offset by recoveries above)	245,247
Interdepartmental Charges such as fleet charges - 2018 rates estimated prior to preparation of final rates in the 2018 Tax Supported Operating Budget	(29,575)
Miscellaneous Net Items (Individually under $25,000)	(64,543)
Sub-total Expenditures	***562,276***
Total Water Operating Surplus	**$864,209**

Water operational revenues are significantly impacted by consumption patterns. Extreme wet or dry conditions can dramatically impact consumption, particularly for residential users. Although there has been a downward trend in average residential consumption in recent years, as a result of water conservation measurers, an increase in the number of users has offset this reduction and the County is starting to experience increases in annual consumption. Staff will continue to monitor this trend and incorporate it into future budget analysis as required. Commercial and Industrial revenues resulted in a favourable variance of approximately $231,000 (10.9%) - this was due to a surplus in large industrial consumption of approximately $288,900, which was partially offset by a deficit in commercial basic charges and consumption of approximately $57,600. The New Credit water recoveries had increased usage both for residential and at the depot. As well, Jarvis and Hagersville water depots had large surpluses, with Dunnville water depot experiencing a minor surplus. Continued monitoring of consumption patterns will assist in predicting future demand and budget implications. Net water operating surpluses are transferred to the Water Rate Stabilization Reserve, to a maximum reserve balance of 25% of applicable rate revenue, with amounts exceeding 25% for four years in a row be contributed to the applicable Capital Replacement Reserve Fund (CRRF). As a result, $4.4 million was transferred to CRRF-Water. The Water Rate Stabilization Reserve has a balance of approximately $1.5 million as at December 31, 2018.

TABLE 6

2018 Operating Variance Analysis for Rate Supported Operations - Wastewater

Revenues:	**Surplus(Deficit)**
Residential User Rates Revenue - Basic and Consumption	251,024
Commercial/Industrial User Rates - Basic and Consumption	(59,937)
Recoveries from Norfolk (Sludge Storage)	(13,703)
Septic/Holding Charges	62,444
Bulk Processing Leachate - Higher treatment levels at both sites	219,114
Over strength discharge recoveries (due to higher volumes than budget)(offset by contribution to reserve below)	94,340
Water Meter Installations and Connection Permits (Wastewater Portion- projections amended in 2019 budget)	(34,519)
Rodding Service Charges	10,377
Miscellaneous net items (individually under $25,000)	11,408
Subtotal Revenues	**540,547**
Expenditures:	
Salaries & Wages (shift in distributed wages based on additional hours allocated to wastewater operations; partially offset by gapping - total surplus of $37,600)	(34,188)
Billing and Collecting Costs	32,976
Hydro	79,381
Taxes & Local Improvements	12,844
Interdepartmental Charges such as fleet charges - 2018 rates estimated prior to preparation of final rates in the 2018 Tax Supported Operating Budget	(21,705)
Transfer to Wastewater Rate Stabilization Reserve (due to increased overstrength charges) (offset)	(94,340)
Miscellaneous net items (individually under $25,000)	65,891
Subtotal Expenditures	**40,860**
Total Wastewater Operating Surplus	**$581,407**

The wastewater surplus is partially due to increased residential consumption. Although the majority of water users also have wastewater services, a number of these customers (approximately 200 users including several large industrial users) only have water services. As a result, annual fluctuations in water consumption may not have the same corresponding impact on wastewater revenues. Increased residential wastewater basic and consumption charges resulted in a favourable variance of approximately $251,000 (5.6%) due to increased number of users and an overall increase in consumption. However, the commercial and industrial basic and consumption charges are slightly under budget by approximately $60,000 on a budget of approximately $1.8 million. The bulk processing revenues were over budget in leachate by approximately $219,000 due to increased volumes. The net wastewater surplus is transferred to the Wastewater Rate Stabilization Reserve, which has a balance of approximately $2.9 million as at December 31, 2018.

As detailed above, the operating surplus/(deficits) in water and wastewater operations are transferred to or funded from the applicable rate stabilization reserve. A multi-year plan has been established to ensure these reserves have sufficient funds to cover annual fluctuations in operations. The impact of the current year's surplus or deficit will be re-evaluated with future operating budget reviews.

Summary of Operational Variances:

To summarize the above analysis, although there are significant variations in certain revenue sources or expenditures in many operational areas, staff worked diligently during the 2018 calendar year to offset most of the negative fluctuations through changes to approved expenditure plans. The end result is limited net surpluses and deficits in most controllable operational areas. Some of these fluctuations can be expected as a historical recurrence (for example, salary gapping) or unpredictable (for example, winter control), so variances should be anticipated as a normal result of such diverse operations. Finding significant expenditure savings to mitigate repeated revenue shortfalls or expenditure overruns is not a realistic solution on an ongoing basis without a negative impact on service delivery. Steps have and will continue to be taken to deal with the revenue shortfalls and re-occurring expenditure overruns that the County is experiencing in certain areas of its operations. On the other hand, areas of continued surplus also need to be re-examined to ensure the annual operating budget is not too conservative from a tax levy and user rates perspective. This will be an ongoing focus of future budget reviews, both from a preparation and monitoring perspective, in order to ensure the sustainability of the County's operations and service delivery.

FINANCIAL/LEGAL IMPLICATIONS:

The transfer of the audited 2018 operating surpluses (or funding of deficits) to or from various reserves or reserve funds provides a means of ensuring the prior year's variance is not carried forward to the future year's budget. The reserves and reserve funds also provide a source of financing for unexpected or future expenditures and are particularly appropriate to fund one-time costs. During the preparation of the annual operating budgets, the balances in the respective reserves and reserve funds are evaluated and plans are recommended to replenish these funds where necessary.

STAKEHOLDER IMPACTS:

Division Managers review their budgets regularly during the year and attempt to mitigate variances within their relevant operations to the best of their ability.

REPORT IMPACTS:

Agreement: No

By-law: No

Budget Amendment: No

Policy: No

ATTACHMENTS:

1. Building Division Statement of Activities 2009-2018
2. Parkland Dedication Reserve Fund Statement of Activities 2018
3. Auditors Report from Millard, Rouse & Rosebrugh, dated October 21, 2019, accompanied by a copy of Haldimand County's 2018 Audited Financial Statements