

## Municipal Financial Reporting Requirements

Section 276 of the Municipal Government Act (MGA) requires every municipality to prepare its annual financial statements in accordance with the generally accepted accounting principles for municipal governments recommended by the Canadian Institution of Chartered Accountants (CICA), and in accordance with any modification of the principles or supplementary requirements established by the Minister of Municipal Affairs.

Sections 277 and 278 of the MGA require municipalities to prepare an audited financial information return (FIR) annually. The Financial Information Return Regulation provides that the FIR is to be prepared in accordance with CICA recommendations and the standards and principles set out in the "*Financial Information Return Manual*".

The annual financial statements and the FIR must be submitted to the Minister, together with an auditor's report regarding each, by May 1 of each subsequent year.


Local Government Services makes available the "Sampleford" specimen financial statements, prescribed FIR forms, the accompanying manual, and other related information to assist municipalities with meeting the reporting requirements. The package may be downloaded from the Alberta Municipal Affairs Internet site at:

<http://www.municipalaffairs.gov.ab.ca/mahome/ms/MFISreturn.cfm>.

It is recommended that the "Public Sector Accounting Board Recommendations" and "Significant Changes to Sampleford" documents, which highlight any changes in reporting requirements each year, be given special attention.

Please contact the Financial Advisory Unit, Local Government Services Division, at (780) 427-2225 with any questions about municipal financial reporting requirements.





# *Municipal Financial Reporting in Alberta*

## Responses to Frequently Asked Questions

**T**his article provides responses to three frequently asked questions about municipal financial reporting in Alberta:

1. What are generally accepted accounting principles for municipal governments recommended by the Canadian Institute of Chartered Accountants (CICA) and where do I find them?
2. What are the key requirements of CICA's Recommendations for municipalities?
3. Who is responsible for setting these Recommendations and how are the Recommendations set?

The questions arise from the Municipal Government Act of the Province of Alberta (Chapter M-26.1 of the Statutes of Alberta 1994) which requires municipalities in Alberta to prepare annual financial statements in accordance with

- a) the generally accepted accounting principles for municipal governments recommended from time to time by the Canadian Institute of Chartered Accountants, and
- b) any modification of the principles or any supplementary accounting standards or principles established by the Minister by regulation.

## 1. What is GAAP for Municipalities in Alberta?

Since 1989, the CICA's Public Sector Accounting and Auditing Board has been recommending accounting and auditing standards for local governments after a 1985 study found dramatic inconsistencies in the financial reporting practices of municipalities. The Recommendations are issued as sections in the Public Sector Accounting and Auditing Handbook. The specific Accounting Sections that are applicable to Local Governments are set out in *Exhibit 1*.

While there is no substitute for reading the above Public Sector Handbook Sections, this article highlights the main Recommendations contained in the above Sections.

## 2. What are the key requirements?

The Recommendations for financial reporting by municipal governments are made within the context of five objectives of financial statements in accordance with PS 1700 as set out in *Exhibit 2*.

To meet these objectives PSAAB recommends that any set of public sector financial statements should have certain attributes, for example, financial statements should:

- be clearly identified and should include an acknowledgment of who is responsible for their preparation;
- include a comparison of current period amounts with those of the prior period;
- include a comparison of actual results with budget information prepared on a basis consistent with that used for actual results; and
- be issued on a timely basis.

Public Sector Accounting and Auditing Section PS 1800, which sets out the general standards for the presentation of financial statements, is a key Handbook Section that would require compliance for financial statements to be in accordance with CICA's recommended principles for municipalities. Requirements include:

- ◆ *Municipal financial statements should include as a minimum,*
  - a statement of financial position,
  - a statement of financial activities, and
  - a statement of changes in financial position.

### *Exhibit 1*

#### Public Sector Handbook Sections

PS 1300	Financial Reporting Entity
PS 1700	Objectives of financial statements: local government
PS 1800	General standards of financial statement presentation: local government
PS 2100	Disclosure of accounting policies
PS 2400	Subsequent events
PS 3030	Temporary investments
PS 3050	Loans receivable
PS 3230	Long-term debt
PS 3310	Loan guarantees
PS 3410	Government transfers

#### ◆ *Consolidated financial statements*

The prime statements mentioned above should be prepared on a consolidated basis for the total municipality. Financial transactions in individual funds would be combined and any inter-fund balances and transactions eliminated.

Additional statements of organizational units and funds may be included as supplementary statements.

#### ◆ *Liabilities*

Municipalities should report all liabilities on the statement of financial position.

Liabilities are financial obligations to outside organizations and individuals as a result of transactions and events on or before the end of the accounting period. They are the result of contracts, agreements and legislation in force at the end of the accounting period that require the local government to repay borrowings or to pay for goods and services acquired or provided prior to the accounting date. Liabilities include longer-term liabilities, such as vested sick leave benefits and unfunded pension liabilities. Excluding any liability does not provide users with a complete overview and understanding of the local government's financial position.

#### ◆ *Financial Assets*

Municipalities should report their financial assets on the statement of financial position.

Financial assets are those assets on hand, at the end of the accounting period, which could provide resources to discharge existing liabilities or finance future operations. They include cash and realizable

## **Exhibit 2: Objectives of Municipal Financial Statements:**

### **Objective 1**

Financial statements should communicate reliable information relevant to the needs of those for whom the statements are prepared, in a manner that maximizes its usefulness. As a minimum, this requires information that is clearly presented, understandable, timely and consistent.

### **Objective 2**

Financial statements should provide an accounting of the full nature and extent of the financial affairs and resources for which the local government is responsible including those related to the activities of its agencies and enterprises.

### **Objective 3**

Financial statements should demonstrate the accountability of a local government for the financial affairs and resources entrusted to it.

(i) Financial statements should provide information useful in evaluating the local government's performance in the management of its financial affairs and resources.

(ii) Financial statements should provide information useful in assessing whether financial resources were administered by the local government in accordance with the limits established by the appropriate legislative and regulatory authorities.

### **Objective 4**

Financial statements of a local government should account for the sources, allocation and use of the financial resources in the period.

(i) Financial statements should account for expenditures by function and object, revenues by source and type and the extent to

which revenues were sufficient to meet expenditures.

(ii) Financial statements should show how the local government financed its activities in the period and how it met its cash requirements.

### **Objective 5**

Financial statements should present information to display the state of a local government's finances.

(i) Financial statements should present information to describe a local government's financial condition at the end of the accounting period.

(ii) Financial statements should provide information useful in evaluating the ability of a local government to finance its activities and to meet its liabilities and commitments.

assets which are convertible to cash and not intended for consumption in the normal course of operations. Financial assets do not include inventories of supplies, equipment and other acquired physical assets with economic lives extending beyond the accounting period.

### ◆ **Statement of financial activities**

The statement of financial activities should account for the difference between a local government's revenues and expenditures, adjusted for any changes in valuation allowances, in the accounting period.

Revenues include such items as taxation, user fees, grants and other transfers. They do not include borrowings, such as debenture proceeds, or transfers from other funds. Expenditures are the cost of goods and services acquired in the period whether or not payment has been made or invoices received, and include transfer payments due where no value is received directly in return.

Expenditures include amounts for goods and services such as: salaries and wages; post-employment benefits; supplies; interest on debt and capital expenditures. They do not include debt repayments or transfers to other funds.

### ◆ **Fund balances**

The statement of financial activities should also account for the combined change in the balances of a local government's funds. Reporting information about the changes in its fund balances helps users to assess the local government's short-term revenue requirements, and its ability to finance its operations and meet its current obligations. In most cases, fund balances will not be the same as the difference between revenues and expenditures because certain long-term operating expenditures such as vested sick leave benefits are recognized in the funds when revenues are raised to pay for them. In addition, debt principal repayments and long-term capital financing are usually included in the individual funds even though these amounts are not expenditures or revenues of the local government.

Financial statements should disclose a local government's current, capital and reserve fund balances at the end of the accounting period. Financial statements should also disclose the changes in the municipality current, capital and reserve fund balances in the accounting period.

The current fund balance describes the amount to be included in a following year's revenue

requirements. The current fund balance should be described in terms of either the amount available to offset future revenue requirements or the amount that is required to be financed from future revenues.

The capital fund balance describes whether or not the local government has secured permanent financing for its capital expenditures or whether it has secured financing but not yet spent the resources raised. Information about that balance should include how the local government intends to finance any unfinanced balance or describe how any unexpended balance would be applied

◆ *Statement of Changes in Financial Position*

- The statement of changes in financial position should report the changes in a local government's cash and cash equivalents during the accounting period. It should classify cash flows by operating, investing and financing activities and report significant non-cash items.

The Local Government Services of Alberta Municipal Affairs has developed a set of specimen financial statements, which follow the intent of the Recommendations. A copy of these specimen financial statements can be obtained from the Local Government Services at (403) 427-2225.

### *3. Who sets the Recommendations?*

The CICA's Public Sector Accounting and Auditing Board is responsible for setting the standards for municipal accounting and financial reporting. The standard-setting process involves a broad cross-section of those who prepare, audit and use government financial statements and reports. And, PSAAB has a broad, representative network of associates which encourages participation and comment from all interested parties.

PSAAB's standards are developed by the people who will be governed or affected by them. Board and task

force members and associates number some two hundred senior people. They include deputy and assistant deputy ministers of municipal affairs, municipal treasurers and auditors.

All PSAAB and task force members are volunteers who serve as individuals and not as representatives of their governments, firms or organizations. Two-thirds of the members of PSAAB and its task forces are selected from the people responsible for government financial reporting and auditing. This helps ensure that PSAAB's accounting standards are appropriate for governments.

In developing those standards, PSAAB follows an open process that provides those who will be affected by the standards with lots of opportunity to input into their development. Associates provide advice to the Board and the task forces at each main stage in the developmental process.

The process includes developing project proposals, issuing and responding to comments from associates on basic principles, drafting and responding to comments on preliminary wording of the proposed new Handbook section, and issuing public exposure drafts and soliciting comments from all interested groups and individuals.

PSAAB offers the resources and skills necessary to initiate and maintain a national standard-setting body. It has a well-developed, broad-based network that can be relied on to contribute the necessary knowledge and expertise in financial reporting issues. In addition, PSAAB follows an extensive due process.

An independent, nationally focused body, such as PSAAB, will help ensure that similar transactions and events are recorded and reported in the same way for each municipality across the country. This not only improves comparability within each province, but also from one province to another.

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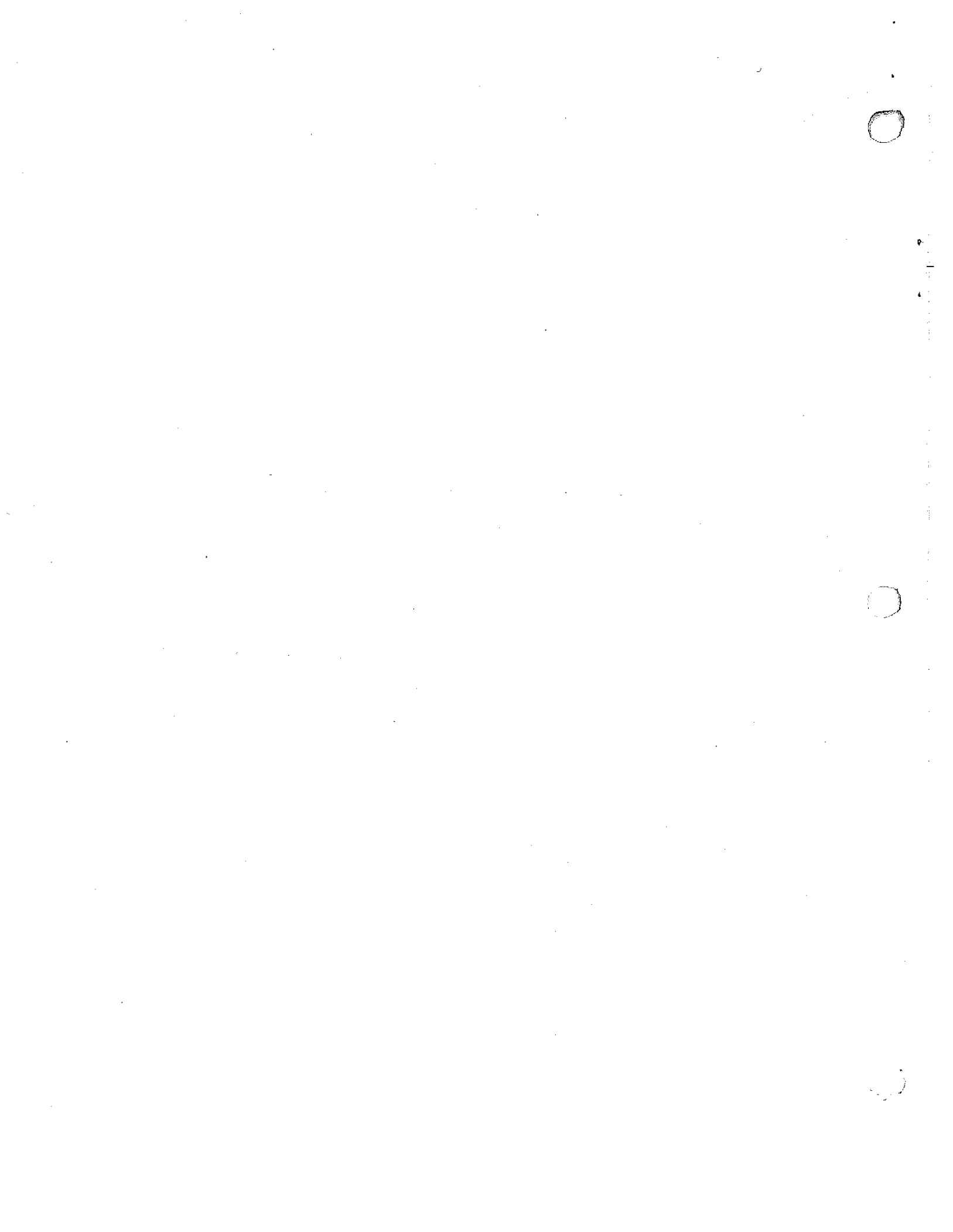
This booklet is intended to be an illustrative guide to applying PSAAB's local government Recommendations (PS Sections 1700 and 1800). The financial statements and the presentations expressed in this document represent only one view as to how PSAAB Recommendations could be applied. Since this document is a non-authoritative guide, the view expressed has not been adopted, endorsed, approved, disapproved and otherwise acted upon by the Public Sector Accounting and Auditing Board of The Canadian Institute of Chartered Accountants.

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Chartered Accountants of Canada  
Comptables agréés du Canada





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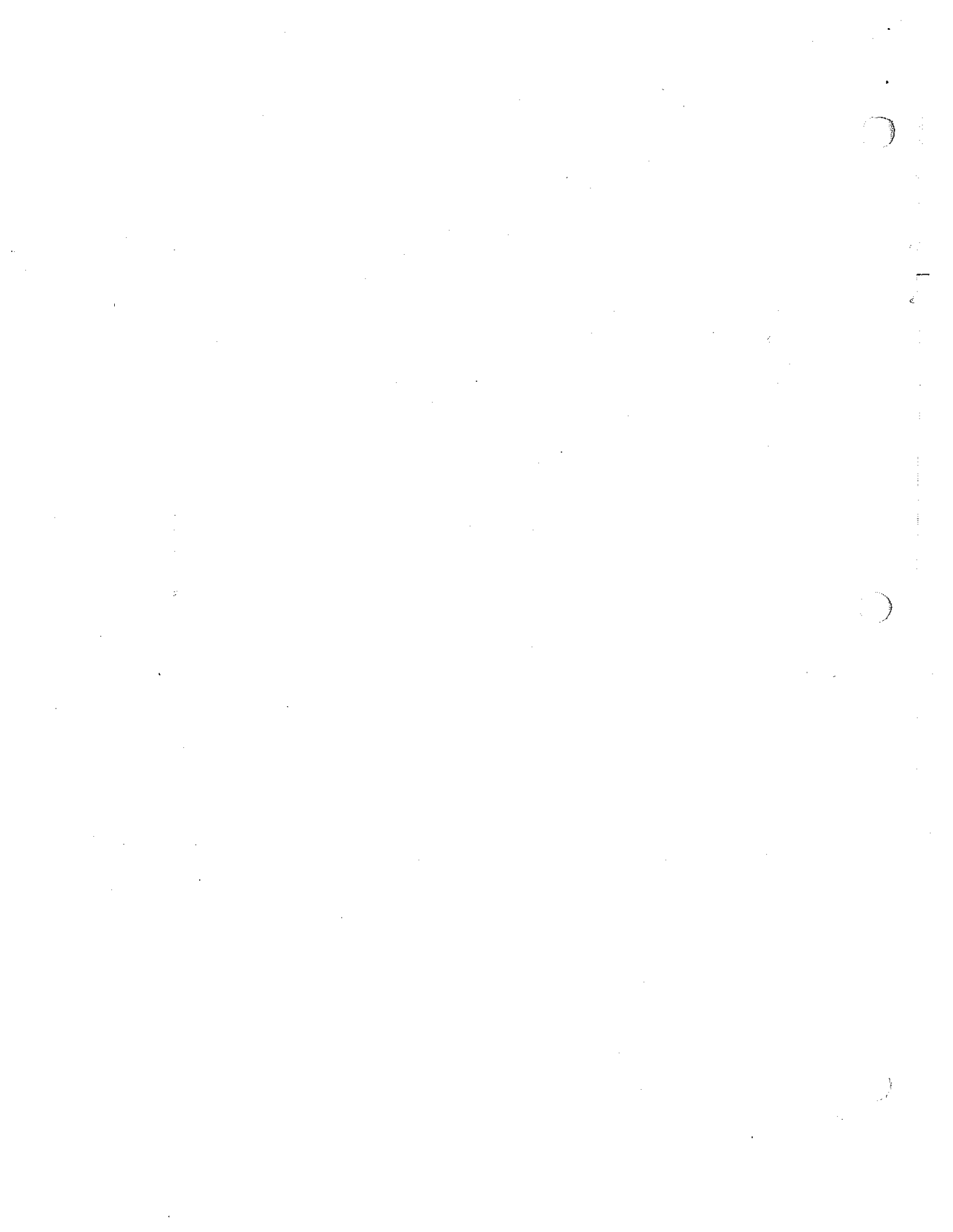
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## Section 1

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# BACKGROUND

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### Introduction

The Canadian Institute of Chartered Accountants' (CICA) *Public Sector Accounting and Auditing Board* (PSAAB) was created in 1981 after an in-depth CICA research study that found dramatic inconsistencies in the way the federal and provincial governments accounted for and reported their financial position and results. A study conducted in 1985 for local governments found similar problems.

In 1989, PSAAB began its local government initiative with the goal of recommending standards of good municipal accounting and financial reporting practices.

### The Need for Standards

Governments spend almost half of the national gross domestic product and affect the lives of all of us. They need accounting standards that result in useful, reliable financial information. Developing those standards and getting governments to adopt them is what PSAAB is all about.

PSAAB's goal is better information for government decision-making and accountability through better accounting and reporting practices.

Accounting and financial reporting standards are important because they set the rules for measuring,

recording and reporting financial information used for management, decision-making and accountability. National standards are important to allow comparisons of the financial position and results of similar municipalities.

Adopting common standards means that differences shown by comparing the financial statements of one government with those of another are not the result of different accounting and reporting practices. They will represent real differences in the way those governments finance, organize and conduct their operations, and in the services they provide.

### The Standard-Setting Process

The standard-setting process involves a broad cross-section of those who prepare, audit and use government financial statements and reports. And, PSAAB has a broad, representative network of associates which encourages participation and comment from all interested parties.

PSAAB's standards are developed by the people who will be governed or affected by them. Board and task force members and associates number some two hundred individuals. They include deputy and assistant deputy ministers of municipal affairs, municipal treasurers and auditors.

All PSAAB and task force members are volunteers who serve as individuals and not as representatives of their governments, firms or organizations. Two-thirds of the members of PSAAB and its task forces are selected from the people responsible for government financial reporting and auditing. This helps ensure that PSAAB's accounting standards are appropriate.

In developing those standards, PSAAB follows an open process that provides those who will be affected by the standards with lots of opportunity to input into their development. Associates provide advice to the Board and the task forces at each main stage in the developmental process.

The process includes developing project proposals, issuing and responding to comments from associates on basic principles, drafting and responding to comments on preliminary wording of the proposed new Handbook section, and issuing public exposure drafts and soliciting comments from all interested groups and individuals.

PSAAB offers the resources and skills necessary to initiate and maintain a national standard-setting body. It has a well-developed, broad-based network that can be relied on to contribute the necessary knowledge and expertise in financial reporting issues. In addition, PSAAB follows an extensive due process.

An independent, nationally focused body, such as PSAAB, will help ensure that similar transactions and events are recorded and reported in the same way for each municipality across the country. This not only improves comparability within each province, but also from one province to another.

## Purpose of this Document

This document explains the changes PSAAB is recommending to improve municipal financial reporting. It also provides highlights of key *PSAAB Recommendations* made to date and provides an illustrative example of how those recommendations could be applied.

Municipal financial reports communicate information to various user groups. They include:

- **the public** – who provide a significant portion of the revenues and resources necessary for municipal operations;
- **council** – who are authorized to administer public financial affairs and resources and are accountable for their administration;
- **regulators such as the province** – who have regulatory authority over municipal operations and financial affairs;
- **investors** – who provide financial resources to the municipality; and
- **analysts** – who provide information to the public and other special interest groups.

To meet the needs of those users, municipal financial reports must provide information that is useful for:

- knowing what is owed and owned by the municipality;
- assessing long-term financial sustainability of the municipality;
- determining the affordability of programs;
- managing liabilities and assets;
- making comparisons between periods and with the approved budget;
- reporting performance and benchmarking; and
- demonstrating stewardship and accountability.

While financial reporting may not appear to be a priority in the changing environment of municipal government, having complete financial information that can be used for making the types of financial decisions necessary in that environment is vital.

Financial decisions, such as those related to amalgamation, downsizing and alternative program delivery choices will need to be made not only by municipal administrators, but also provincial officials and the general public. Having complete financial information available is fundamental to making those decisions.

PSAAB is recommending national accounting and financial reporting standards to improve the understanding, completeness and comparability of municipal financial statements and, therefore, the

financial information that is available to decision-makers and the public.

Ensuring that complete, accurate financial information is available and presented in a way that facilitates decision-making, is a fundamental goal of PSAAB's standard-setting initiative.

## Issues in Financial Reporting

Often missing from the reported financial position and results of a municipality is complete information about liabilities and assets. In addition, the financial statements, themselves, may not provide an adequate overview of the municipality as a whole.

### *Unrecorded Liabilities*

Many municipalities do not report on their balance sheets major long-term liabilities for such things as workers' compensation, pensions, vested sick leave, and other post-employment benefits.

To illustrate, the 1994 balance sheet of a major Canadian municipality reports long-term liabilities of \$700 million. However, the notes to the statements disclose liabilities for unfunded pensions, vested sick leave, workers' compensation and post employment benefits amounting to about \$600 million.

Reporting that amount on the balance sheet would show long-term liabilities of \$1.3 billion, not \$700 million, which could significantly change a user's view (e.g., the province's) of the municipality's reported financial position and results of operations.

Unrecorded liabilities represent a charge for services already rendered, that have to be met with future tax or other revenues. And, as the previous example illustrates, that charge and those liabilities, which are just as real as market borrowing, can be substantial.

Managing debt, not only long-term debenture debt but also other long-term liabilities, is a vital function of municipal governments and one that needs to be closely

monitored by the provinces. Local government administrators and regulators need to know what the municipality owes in order to assess what level of services it can afford to sustain, and to plan its financing. Municipalities, therefore, need to ensure that all liabilities are accounted for and reported in their financial statements.

### *Accounting for Physical Assets*

Besides managing debt, local governments are responsible for managing vast stocks of physical assets such as buildings, equipment, water and sewer systems and roads.

Information about those assets is also missing from local government financial statements and even when certain information about physical assets is reported, it is reported in very different ways. For example:

- The City of Calgary reports its user fee supported assets at cost and depreciates them.
- The City of Winnipeg generally reports capital assets at the value of the unpaid debt borrowed to acquire them.
- The City of Montreal records its capital assets at acquisition but does not depreciate them — they are carried at cost on the books and written off in full after a specified time period.

Except for some utilities commissions and corporations, local governments do not account for and report their capital assets the way that businesses do. As a result, information that is essential for asset management and program costing is not produced by the financial information system, not under accounting control, and is not reported in the financial statements.

Without recording assets in the books of account and allocating the cost of using them to specific departments, managers do not know the full cost of its programs and services, nor can they assess performance or the cost of a service in relation to its benefits. In addition, elected councils do not have these facts for planning and budgeting purposes. Departments of municipal affairs cannot fulfill their oversight responsibilities on the state



of a municipality's infrastructure, its financial condition, and the cost of its programs.

Local government administrators and regulators need to know what assets the local government has and their state of repair in order to continue to provide essential services and assess any maintenance and replacement requirements. They also need to know what programs cost in order to make service delivery choices. Municipalities, therefore, need to ensure that all assets are accounted for and reported in their financial statements.

### *Financial Statement Presentation*

Not only is having complete information important, but the way information is presented in the financial statements is also important. How the story is told often governs the messages received.

Local government financial statements can tell the same story very differently in different provincial jurisdictions. For example:

- Some municipalities report their investment in capital assets as part of their equity. Others do not. And, even in those that do, the accounting for capital assets varies considerably.
- The scope of activities included in a local government's financial statements also varies widely. Some report each fund separately. Others combine their funds to provide a broader picture.
- Many municipalities do not include major operating units such as housing corporations and utilities in their financial statements. And, those that do include utilities do so in a variety of ways.

These are only a few examples of variations in financial statement presentation that can affect a reader's interpretation of a local government's financial situation.

What they do show is that it is difficult to get a full picture of the nature and extent of the financial resources and affairs for which the local government is responsible. And, they also show that it is difficult to

determine the demands on future revenues from the financial statements.

The issue is reporting complete information about all of the activities for which a municipality is responsible and, adopting national accounting standards to ensure that information is fairly and consistently measured.

### **Progress to Date**

PSAAB's objectives are to establish a comprehensive body of accounting and financial reporting standards that are appropriate for governments and governmental organizations, and to encourage governments to accept and comply with those standards.

The first step in developing generally accepted accounting principles for local governments was to define the objectives and scope of their financial statements to meet the information needs of the users of the statements, and to prescribe general reporting and presentation standards to ensure full and fair disclosure of information in financial statements.

That framework of objectives and fundamental principles has now been completed and constitutes the basis for PSAAB's other accounting recommendations. For example, that framework requires local governments to record and report all of their liabilities, and to properly define and value their financial assets. It also requires them to prepare consolidated financial statements that include all of their funds, agencies and enterprises.

PSAAB is now dealing with accounting for physical assets — property such as roads, water and sewer systems, buildings, computers and transportation. This is probably the most controversial subject in municipal government accounting because changing the accounting for physical assets could radically change the way local governments report their financial position and the way in which they calculate their annual surpluses or deficits.

Adopting PSAAB's recommendations results in financial statements that paint a more complete and fair picture of a government's financial position and results. For

example, provincial governments now report tens of billions of dollars of previously unrecorded employee pension obligations. They have also written off billions of dollars of loans receivable that were, in essence, grants. The federal and provincial governments now all publish consolidated financial statements that provide a comprehensive accounting of all of the financial resources and activities for which government is responsible.

PSAAB has not only made significant progress in successfully tackling some of the most challenging problems in government accounting but, has also been successful in getting the federal and provincial governments to comply with PSAAB's recommendations.

Significant movements are also under way within many municipal affairs departments aiming to have PSAAB standards adopted for their municipalities.

Alberta now has legislation in place that requires municipalities to follow PSAAB. Efforts are under way in provinces such as British Columbia, Saskatchewan, Manitoba and Ontario to make the acceptance and implementation of *PSAAB Recommendations* the standard for local governments.

What follows in Section 2 are highlights of key *PSAAB Recommendations* made to date. These recommendations deal with the issues of accounting for and reporting all of a municipality's liabilities and financial statement presentation. As noted earlier, PSAAB has not yet addressed the issue of accounting for and reporting physical assets. However, an illustrative statement of financial position has been provided that includes physical assets to assist those municipalities who now have them on their statements of financial position.

The illustrative examples represent only one approach that could be used. Others may be developed or used that would also comply with PSAAB's recommendations.

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## Section 2

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# PSAAB RECOMMENDATIONS

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### Objectives of Municipal Financial Statements

#### *Objective 1*

Financial statements should communicate reliable information relevant to the needs of those for whom the statements are prepared, in a manner that maximizes its usefulness. As a minimum, this requires information that is clearly presented, understandable, timely and consistent.

#### *Objective 2*

Financial statements should provide an accounting of the full nature and extent of the financial affairs and resources for which the local government is responsible including those related to the activities of its agencies and enterprises.

#### *Objective 3*

Financial statements should demonstrate the accountability of a local government for the financial affairs and resources entrusted to it.

(i) *Financial statements should provide information useful in evaluating the local government's performance in the management of its financial affairs and resources.*

(ii) *Financial statements should provide information useful in assessing whether financial resources were administered by the local government in accordance with the limits established by the appropriate legislative and regulatory authorities.*

#### *Objective 4*

*Financial statements of a local government should account for the sources, allocation and use of the financial resources in the period.*

(i) *Financial statements should account for expenditures by function and object, revenues by source and type and the extent to which revenues were sufficient to meet expenditures.*

(ii) *Financial statements should show how the local government financed its activities in the period and how it met its cash requirements.*

### *Objective 5*

*Financial statements should present information to display the state of a local government's finances.*

- (i) Financial statements should present information to describe a local government's financial condition at the end of the accounting period.*
- (ii) Financial statements should provide information useful in evaluating the ability of a local government to finance its activities and to meet its liabilities and commitments.*

To meet these objectives PSAAB recommends that any set of public sector financial statements should have certain attributes, for example, financial statements should:

- be clearly identified and should include an acknowledgment of who is responsible for their preparation;
- include a comparison of current period amounts with those of the prior period;
- be issued on a timely basis; and
- include, as a minimum, a statement of financial position, a statement of financial activities and a statement of changes in financial position.

For each individual financial statement, PSAAB has made specific Recommendations on form and content. Highlights of the main Recommendations and an illustration by statement follows.

## Statement of Financial Position

The overall objective of the statement of financial position identified by PSAAB, to date, is to ensure that all financial assets of the municipality and all liabilities of the municipality are recorded and reported on the statement of financial position.

The statement of financial position of a municipality is intended to present an understandable overview of the financial position of the municipality as a whole. Thus, for each financial statement item, the statement of financial position would present the total for the municipality. As such, any interfund balances would be eliminated.

Reporting all financial assets and liabilities on the statement of financial position ensures that information is presented about the municipality's future revenue requirements and its ability to finance its activities and meet its obligations in the future.

Financial assets are those assets on hand which could provide resources to discharge existing liabilities or finance future operations. They do not include inventories of supplies, equipment and other acquired physical assets. Physical assets are not financial assets because they do not normally provide resources to discharge existing obligations or finance future operations.

Segregating financial assets by main classification and disclosing information about their nature and terms provides the information necessary for understanding and assessing the financial resources available to discharge liabilities both in the short and long-term, or to finance future operations.

As such, the municipality's statement of financial position should report financial assets segregated by main classification such as:

- cash and temporary investments;
- receivables;
- inventories for resale; and
- investments.

Liabilities are financial obligations to outside organizations that are the result of contracts, agreements and legislation in force at the end of the accounting period that require the municipality to repay borrowings or to pay for goods and services acquired or provided prior to the accounting date.

The exclusion of long-term liabilities such as vested sick leave benefits or unfunded pension obligations does not provide users with a complete understanding of the municipality's financial position or future revenue requirements.

Segregating liabilities on the statement of financial position and disclosing information about their nature and terms provides the information necessary for understanding and assessing the future demands on financial resources and future revenue requirements needed to discharge those amounts.

As such, the municipality's statement of financial position should report liabilities segregated by main classification such as:

- temporary loans payable;
- accounts payable and accrued liabilities;
- deferred revenues;
- post-employment benefits; and
- long-term obligations.

Municipalities now report fund balances as an indicator of their short-term financial position. Another important indicator of financial position is the difference between financial assets and liabilities because this difference provides information about the municipality's overall future revenue requirements and its ability to finance its activities and meet its obligations.

The example on the opposite page (*Exhibit A*) shows how financial assets, liabilities, municipal fund balances and the net financial position of the municipality could be presented.

Exhibit A

The Municipality of Your Town  
 Illustrative Statement of Financial Position  
 as at December 31, 1996

	1996 Actual (\$000s)	1995 Actual (\$000s)
<b>Financial Assets</b>		
Cash and Temporary Investments	109,339	102,584
Receivables		
Provincial Grants	11,599	10,146
User fees	8,269	7,680
Other	7,699	5,144
Other Current Assets	<u>3,272</u>	<u>2,462</u>
<b>Total Financial Assets</b>	<u>140,178</u>	<u>128,016</u>
<b>Liabilities</b>		
Accounts Payable and Accrued Liabilities	29,548	33,148
Long-term Debt Outstanding <sup>(1)</sup>	77,536	52,596
Other Long-term Liabilities <sup>(1)</sup>	<u>5,957</u>	<u>5,087</u>
	<u>113,041</u>	<u>90,831</u>
<b>Financial Position</b>		
<b>Fund Balances</b>	<b>110,630</b>	<b>94,868</b>
Amounts to be Recovered from Future Revenues <sup>(1)</sup>	<u>(83,493)</u>	<u>(57,683)</u>
<b>Net Financial Assets/(Liabilities)</b>	<b>27,137</b>	<b>37,185</b>
	<u>140,178</u>	<u>128,016</u>

*(1) Amounts to be Recovered from Future Revenues represents the sum of the long-term debt outstanding and other long-term obligation such as vested sick leave benefits. The advantage of this approach is that it maintains the current practice of reporting fund balances while, at the same time, allowing for any unrecorded long-term obligations to be reported on the statement of financial position.*



## Statement of Financial Position (Physical assets included)

In some provinces, municipalities now report an amount for physical assets on their statement of financial position.

Since PSAAB has not yet pronounced on accounting and reporting of physical assets for local government, some guidance needs to be provided to those municipalities now reporting an amount for physical assets on their statement of financial position.

Generally, those assets are not depreciated, but an investment in physical assets forms part of the municipal equity. That investment typically represents the net book value of those assets minus any outstanding long-term debt that has been issued to finance the asset. As long-term debt is repaid, for example, the investment in physical assets increases.

The example on the opposite page (*Exhibit B*) shows the historical net book value of physical assets as part of total assets. Because, for local governments, long-term debt is generally issued for the acquisition of long-term assets, the related long-term debt is deducted from the book value to display an investment or equity in physical assets.

In some jurisdictions, any capital work-in-progress is shown as part of that investment in physical assets. In this example, the capital fund, or work-in-progress, has been separated from the investment in physical assets. The capital fund balance forms part of the total fund balances.

Exhibit B

**The Municipality of Your Town**  
**Illustrative Statement of Financial Position**  
**as at December 31, 1996**

	1996 Actual (\$000s)	1995 Actual (\$000s)
<b>Financial Assets</b>		
Cash and Temporary Investments	109,339	102,584
Receivables		
Provincial Grants	11,599	10,146
User fees	8,269	7,880
Other	7,699	5,144
Other Current Assets	<u>3,272</u>	<u>2,462</u>
<b>Total Financial Assets</b>	<u>140,178</u>	<u>128,016</u>
<b>Physical Assets</b>		
Land and Buildings	10,250	11,500
Infrastructure	750,000	800,000
Machinery and Equipment	65,000	85,000
Vehicles	<u>25,000</u>	<u>35,000</u>
<b>Total Physical Assets <sup>(1)</sup></b>	<u>850,250</u>	<u>931,500</u>
<b>Total Assets</b>	<u>990,428</u>	<u>1,059,516</u>
<b>Liabilities</b>		
Accounts Payable and Accrued Liabilities	29,548	33,148
Long-term Debt Outstanding <sup>(1)</sup>	77,536	52,596
Other Long-term Liabilities	5,957	5,087
	<u>113,041</u>	<u>90,831</u>
<b>Financial Position</b>		
Fund Balances	110,630	94,868
Unfunded Employee Benefits	(5,957)	(5,087)
Investment in Physical Assets <sup>(1)</sup>	772,714	878,904
	<u>877,387</u>	<u>968,685</u>
	<u>990,428</u>	<u>1,059,516</u>

(1) The investment in physical assets represents the net book value of those assets minus any long-term debt that has been issued to finance those assets.

## Statement of Financial Activities

The overall objective of the statement of financial activities as identified by PSAAB is to ensure that all revenues, expenditures and the changes in fund balances are recorded and reported on the statement of financial activities.

The statement of financial activities is intended to present an understandable overview of the results of operations for the municipality as a whole. Thus, for each financial statement item, the statement of financial activities would present the total for the municipality. As such, any interfund transactions would be eliminated.

Reporting all revenues and expenditures on the statement of financial activities ensures that information is presented about the municipality's sources, allocation and uses of financial resources, and provides the user with an indication as to whether revenues were sufficient to meet expenditures.

Revenues should be accounted for in the period in which the transactions or events occurred that gave rise to the revenues. Accounting for revenues at this time ensures that the related financial assets are accounted for in the period they are created.

The statement of financial activities should report revenues segregated by significant types of revenues. Revenues include such items as taxation, user fees, grants and other transfers. They do not include borrowings, such as debenture proceeds, or transfers from other funds. Segregating revenues by significant types is useful for understanding and assessing the impact of revenue-raising on the economy, the relative contributions of revenues sources and the revenue-producing capacity of investments.

Expenditures should be accounted for in the period the goods and services are acquired and a liability is incurred. Accounting for expenditures at this time ensures related liabilities are accounted for in the period they are created.

\* Expenditures include amounts for goods and services such as: salaries and wages; post-employment benefits; interest on debt and capital expenditures. They do not include debt repayments or transfers to other funds.

The statement of financial activities should report expenditures by function. Major functions may include environmental services, transportation, protection to persons and property, health services, social and family services, recreation, planning and development, and general government. Reporting expenditures by function is useful for understanding and assessing the social impact of those amounts on the local economy.

Information about objects of expenditure should be disclosed in the notes. Major objects of expenditure would include salaries and wages, purchased goods and services, and interest on debt. Reporting expenditures by object is useful for understanding the economic impact those amounts have on the economy.

The statement of financial activities should account for the difference between revenues and expenditures as this difference shows whether the revenues raised were sufficient to meet the expenditures or whether some of those expenditures were financed with debt or prior years' surpluses. This difference is important as it explains the change in net financial assets or liabilities of the municipality.

In most cases, the difference between revenues and expenditures will not be the same as the change in fund balances so the statement of financial activities should also account for the total change in fund balances. Certain long-term expenditures such as vested sick leave benefits are only recognized in the funds when revenues are raised to pay for them, and the funds often include amounts for debt principal repayment and debt proceeds. Reporting this change is important because it explains the change in the municipality's fund balances (*see Exhibit C*).

Exhibit C

**The Municipality of Your Town  
Illustrative Statement of Financial Activities  
for the period ended December 31, 1996**

	1996 Budget (\$000s)	1996 Actual (\$000s)	1995 Actual (\$000s)
<b>Revenues</b>			
Taxation	54,000	53,372	48,256
User Fees	74,000	72,918	70,115
Government Transfers	65,000	63,705	51,959
Investment Income	11,000	10,523	13,162
Other	10,000	8,956	10,276
	<u>214,000</u>	<u>209,474</u>	<u>193,768</u>
<b>Expenditures</b>			
General Government	18,000	17,143	15,905
Environmental Services	90,000	81,930	90,800
Social Services	50,000	50,463	35,917
Protection to Persons/Property	45,000	47,372	42,412
Transportation	10,000	10,065	8,303
Health Services	9,000	8,525	7,787
Planning and Development	2,000	2,564	2,621
Recreation and Culture	1,500	1,460	1,958
	<u>225,500</u>	<u>219,522</u>	<u>205,703</u>
<b>Change in Net Financial Assets</b>	<b>(11,500)</b>	<b>(10,048)</b>	<b>(11,935)</b>
ADD: Debentures Issued	8,500	32,795	1,419
Change in Other Long-term Liabilities		870	-
LESS: Debentures Repaid	(8,000)	(7,855)	(9,230)
<b>Change in Amounts to be Recovered</b>	<b>500</b>	<b>25,310</b>	<b>(7,811)</b>
<b>Change in Fund Balances</b>	<b>(11,000)</b>	<b>15,762</b>	<b>(19,746)</b>

## Statement of Changes in Financial Position

The overall objective of the statement of changes in financial position is to ensure that information about the effects a municipality's activities has on its cash resources is reported on the statement of changes in financial position.

A statement of changes in financial position reports the effects of a municipality's activities on its cash resources by showing how the municipality financed its activities and met its cash requirements. Important uses of such information include evaluating the municipality's liquidity and assessing its future revenue requirements.

The statement of changes in financial position (*see Exhibit D*) is intended to present an understandable overview of changes in cash and cash equivalents for the municipality as a whole. Thus, for each financial statement item, the statement of changes in financial position would present the total for the municipality. As such, any interfund balances would be eliminated.

Cash and cash equivalents represent a pool of cash or ready cash available to the municipality and would include amounts for such items as cash and temporary investments, net of any temporary borrowings. The change in cash resources can be explained in the context of three major activities – operations, investing and financing.

Cash flow information related to operations would reconcile the amount of cash used or available from operations. Significant non-cash items in revenues and expenditures should be reported. Cash flow information related to investing would include investments made and realized during the period. Cash flow information related to financing includes amounts raised through long-term financing and any amounts repaid during the period.

Exhibit D

The Municipality of Your Town  
 Illustrative Statement of Changes in Financial Position  
 for period ended December 31, 1996

	1996 (\$000s)	1995 (\$000s)
<b>Operations</b>		
Net before Financing Activities	(10,048)	(11,935)
LESS:		
Increase in Accounts Receivable	(4,597)	(4,543)
Increase in Other	(810)	
Decrease in Accounts Payable	<u>(3,600)</u>	<u>(2,400)</u>
Net Cash from Operations	(19,055)	(18,878)
<b>Investing</b>		-
<b>Financing</b>		
Long-term Debt Issued	32,795	1,419
Long-term Debt Repaid	(7,855)	(9,230)
Other Long-term Liabilities	<u>870</u>	<u>-</u>
Net Cash from Financing	25,810	(7,811)
<b>Change in Cash and Cash Equivalents</b>	<b>6,755</b>	<b>(26,689)</b>
<b>Opening Cash and Temporary Investments</b>	<b><u>102,584</u></b>	<b><u>129,273</u></b>
<b>Closing Cash and Temporary Investments</b>	<b><u>109,339</u></b>	<b><u>102,584</u></b>



## Reporting on Funds

The overall objective of the fund schedules identified by PSAAB is to ensure that information about the municipality's current, capital and reserve fund transactions and balances is presented.

Generally, municipalities account for and report transactions on a fund basis. Information about fund balances is useful in assessing a municipality's financial position and results because it provides information that is comparable to the cash requirements budget, the status of the funding for capital expenditures, and about amounts that have been set aside to finance future expenditures.

Reporting information about fund balances helps users assess the municipality's short-term revenue requirements. Reporting information about the changes to those balances is also useful in understanding decisions made about the allocation of resources to meet either current expenditures, capital expenditures or amounts that have been set aside in reserve.

In most cases, the change in fund balances will not be the same as the difference between revenues and expenditures because certain long-term operating expenditures such as vested sick leave benefits are recognized as expenditures in the current fund only when revenues are raised to pay for them. In addition, debt principal repayments and long-term capital financing are usually included in the individual funds even though these amounts are not expenditures or revenues of the municipality.

Information about the current fund balance (*see Exhibit E*) is useful because it describes the amount to be included in a following year's revenue requirements. Reporting changes in the current fund balance is important because it describes the uses of the revenues raised by the municipality and provides information that is easily comparable to the cash requirements budget or the basis of the mill rate. Information provided would describe the total revenue raised, operating expenditures,

transfers to or from other funds, and amounts required for debt repayment.

Information about the capital fund balance (*see Exhibit F*) is important because it describes whether or not the municipality has secured permanent financing for its capital expenditures or whether it has secured financing but has not yet spent the resources raised. Reporting changes in the capital fund is important as it represents the timing differences between the sources and uses of financing. Information provided would describe revenues and long-term financing, capital expenditures, and any transfer to or from other funds.

Information about the reserve fund balance (*see Exhibit G*) is important because it describes the total amounts that the municipality has set aside for future expenditures. Reporting changes in the reserve fund balance is important because it describes the amounts that have been set aside or the amounts used to finance current period expenditures. Information provided would describe the amounts transferred to or from other funds.

Exhibit E

The Municipality of Your Town  
 Illustrative Schedule of Current Fund Operations  
 for period ended December 31, 1996

	1996 Budget (\$000s)	1996 Actual (\$000s)	1995 Actual (\$000s)
<b>Revenues</b>			
Taxation	54,000	53,372	48,256
User Charges	74,000	72,918	70,115
Government Transfers	50,000	55,380	48,540
Investment Income	11,000	10,523	13,162
Other	10,000	8,956	10,276
	<u>199,000</u>	<u>201,149</u>	<u>185,349</u>
<b>Expenditures</b>			
General Government	8,000	8,575	7,500
Environmental Services	60,000	53,881	50,604
Social Services	40,000	47,436	34,949
Protection to Persons/Property	40,000	36,918	33,358
Transportation	4,000	3,386	3,299
Health Services	8,000	7,551	7,663
Planning and Development	2,000	2,431	2,437
Recreation and Culture	1,000	911	878
	<u>163,000</u>	<u>161,139</u>	<u>140,688</u>
<b>Net Revenue/(Expenditure)</b>	<b>36,000</b>	<b>40,010</b>	<b>44,661</b>
<b>Debt Principal Repayments</b>	<b>(8,000)</b>	<b>(7,855)</b>	<b>(9,230)</b>
<b>Net Inter-fund Transfers</b>			
(To) From Capital	(13,000)	(12,618)	(11,469)
(To) From Reserves	(16,200)	(18,387)	(22,762)
<b>Change in Current Fund</b>	<b>(1,200)</b>	<b>1,150</b>	<b>1,200</b>
<b>Opening Balance</b>	<u>1,200</u>	<u>1,200</u>	<u>--</u>
<b>Closing Balance</b>	<u><u>--</u></u>	<u><u>3,350</u></u>	<u><u>1,200</u></u>

*Exhibit F*

The Municipality of Your Town  
 Illustrative Schedule of Capital Fund Operations  
 for period ended December 31, 1996

	1996 Budget (\$000s)	1996 Actual (\$000s)	1995 Actual (\$000s)
<b>Revenues</b>			
Government Transfers	15,000	8,325	8,419
	<u>15,000</u>	<u>8,325</u>	<u>8,419</u>
<b>Expenditures</b>			
General Government	10,000	8,568	8,405
Environmental Services	30,000	28,049	40,196
Social Services	10,000	3,027	968
Protection to Persons/Property	5,000	9,584	9,054
Transportation	6,000	6,679	5,004
Health Services	1,000	974	124
Planning and Development	-	83	184
Recreation and Culture	500	549	1,080
	<u>62,500</u>	<u>57,513</u>	<u>65,015</u>
<b>Net Revenue/(Expenditure)</b>	<b>(47,500)</b>	<b>(49,188)</b>	<b>(56,596)</b>
<b>Sources of Financing</b>			
Net Inter-fund Transfers			
(To) From Current	13,000	12,618	11,469
(To) From Reserves	11,000	11,326	36,232
Long Term Financing	8,500	32,795	1,419
	<u>32,500</u>	<u>56,739</u>	<u>49,120</u>
<b>Change in Capital Fund</b>	<b>(15,000)</b>	<b>7,551</b>	<b>(7,476)</b>
<b>Opening Balance</b>	<b>26,191</b>	<b>26,191</b>	<b>33,667</b>
<b>Closing Balance</b>	<b>11,191</b>	<b>33,742</b>	<b>26,191</b>

Exhibit G

The Municipality of Your Town  
 Illustrative Schedule of Reserve Fund Operations  
 for period ended December 31, 1996

	1996 Budget \$	1996 Actual \$	1995 Actual \$
<b>Net Inter-fund Transfers</b>			
(To) From Capital	(11,000)	(11,326)	(36,232)
(To) From Current	<u>16,200</u>	<u>18,337</u>	<u>22,762</u>
<b>Change in Reserve Fund</b>	5,200	7,061	(13,470)
<b>Opening Balance</b>		<u>67,477</u>	<u>80,947</u>
<b>Closing Balance</b>		<u>74,538</u>	<u>67,477</u>
Reserve for Vehicles		10,000	10,000
Reserve for Capital Works		35,000	33,000
Reserve for Arena Expansion		25,000	20,000
Reserve for New Roof		<u>4,538</u>	<u>4,477</u>
<b>Total Reserves</b>		<u>74,538</u>	<u>67,477</u>

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## Section 3

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# THE ROAD AHEAD

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The challenge ahead is to find better ways to communicate information about the state of local government finances to politicians and the public, and to explore performance measurement and reporting.

PSAAB is also undertaking projects on topics of special importance to local governments, such as accounting for closure and post-closure liabilities of solid waste landfill sites, pensions, and accounting for government partnerships, such as public/private agreements.

Most government decision-makers and members of the public find financial statements hard to understand. So, in addition to standard-setting, PSAAB has commissioned a research study to find a better way of telling those people about the state of government's finances.

The study identifies specific key indicators of government's financial condition. Those indicators will, for the most part, represent relationships between different pieces of information in the financial statements and between financial statement information and broader economic information. For example, a common indicator that uses only financial statement information is the ratio of interest charges to government revenues, and, a common indicator that combines financial and economic information is the ratio of debt to gross domestic product.

In addition to identifying financial indicators, the study also examines how to report them, assessing the effectiveness of graphics in presenting trends in key indicators.

This study has the potential to bring forward recommendations that could radically change the way that governments describe and report on their financial condition and their administration of public resources. While the study is aimed directly at the federal and provincial levels of government, its results may have value for municipal governments as well.

PSAAB has also been monitoring developments in performance measurement and reporting but has not yet started any work in this field. However, with nagging deficits and high taxes, governments are being forced to measure performance and assess the effectiveness of their programs and operations.

These are a few of the technical challenges that face the Board. One other great challenge will be to get all governments, including municipalities, to accept and abide by standards that PSAAB recommends.

With the support of the volunteers who serve as members and associates of PSAAB, its task forces and the goodwill of governments, PSAAB will continue towards its objective of better financial information for government decision-making and accountability.

# **SELECTED SOURCES OF OTHER INFORMATION AVAILABLE**

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## **CICA Handbook Collection**

Includes CICA Handbook, PSAA Handbook and Criteria of Control Guidelines and are available on diskettes and CD-ROM for MS Windows and Macintosh.

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## **Local Government Financial Reporting Study**

A comprehensive study of the issues facing municipal accounting and financial reporting.

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## **Financial Reporting by Canadian Municipalities**

A comprehensive review of 60 sets of municipal financial statements from across Canada.

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## **CICA Professional Services Publication and Products**

A catalogue of CICA publications and products.

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**FOR MORE INFORMATION PLEASE WRITE:**

**Order Department**

**The Canadian Institute of Chartered Accountants**

**277 Wellington Street West**

**Toronto, Ontario**

**M5V 3H2**

or call in the Toronto area (416) 977-0748 or 1-800-268-3793 for the rest of Canada.



For more information about PSAAB's local government efforts, projects under way, and its standard-setting process write:

Public Sector Accounting and Auditing Board  
The Canadian Institute of Chartered Accountants  
277 Wellington Street West  
Toronto, Ontario  
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Or call, fax or e-mail PSAAB at: Tel.: (416) 977-3222  
Fax: (416) 977-8585  
e-mail: [ed.psector@cica.ca](mailto:ed.psector@cica.ca)

Or visit our web site at: <http://www.cica.ca>



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