A Quick Guide to Municipal Financial Statements

MUNICIPAL AFFAIRS

June 2010

Government of Alberta
Municipal Affairs

Alberta Municipal Affairs (2010) *A Quick Guide to Municipal Financial Statements*
Edmonton: Alberta Municipal Affairs

For more information contact:

Advisory Resources and Capacity Building
Local Government Services
Alberta Municipal Affairs
17th Floor, Commerce Place
10155 – 102 Street
Edmonton, Alberta T5J 4L4
CANADA

Telephone: 780-427-2225

Toll Free: 310-0000 (in Alberta only)

Fax: 780-420-1016

Website: www.municipalaffairs.gov.ab.ca

ISBN 978-0-7785-8004-1 (print)
ISBN 978-0-7785-8005-8 (internet)

Introduction

This guide has been prepared by Alberta Municipal Affairs and is intended to provide examples and explanations of the typical information contained in a municipality's annual audited financial statements. It will be of interest to municipal officials and other stakeholders who would like to interpret the information provided in the annual financial statements.

Financial statements are intended to report on financial condition as at December 31st each year, to ensure accountability and transparency, and to assist municipalities with long-term and strategic planning. Financial statements are an important tool for a municipal council and administration to use to report to the taxpayers on the municipal services provided with the resources at their disposal.

Legislative Requirements and Reporting Standards

The *Municipal Government Act* (MGA) requires that every Alberta municipality complete annual audited financial statements, a copy of which must be submitted to Municipal Affairs, by May 1 of each year. The financial statements must be prepared in accordance with generally accepted accounting principles for municipal governments in Canada.

Requirements for municipal financial reporting are standardized across Canada and are based on the *Public Sector Accounting Handbook*. As of 2009, municipal financial statements are to be prepared using the net financial assets (debt) model and must include reporting of tangible capital assets. This new approach provides a more complete picture of a municipality's financial condition.

Financial statements provide information on a municipality's financial position in terms of its assets and liabilities, its net debt, its accumulated surplus or deficit, and its tangible capital assets and other non-financial assets. Financial statements also provide a meaningful summary of the sources, allocation and consumption of municipal economic resources, how the activities of the period have affected the municipality's net debt, how municipal activities were financed, and how cash requirements were met. Each indicator gives the readers of the financial statements information about the status of the municipality's finances.

Financial statements must include a statement of financial position, a statement of operations, a statement of change in net debt and a statement of cash flow. Additional supplementary information is provided in schedules and notes to the financial statements.

The Quick Guide to Municipal Financial Statements

A sample of each of the four required municipal financial statements is presented along with explanatory notes and helpful tips. A checklist to assist the readers of the financial statement with analysis and evaluation of the financial statements can be found near the end of this guide. A glossary of terms is also included.

Financial statements must be prepared by municipalities on an annual basis in accordance with provisions set out in the *Municipal Government Act* and its associated Regulations.

There are four main components to the financial statements of a municipality:

The **Statement of Financial Position** is a required statement that reports on:

- assets – what the municipality owns or controls;
- liabilities – what the municipality owes; and
- accumulated surplus – what remains after the assets have been used to meet the liabilities.

The **Statement of Operations** is a required statement that reports on:

- revenues;
- expenses; and
- results for a fiscal year or reporting period.

The **Statement of Change in Net Financial Assets (Debt)** is a required statement that:

- explains the difference between the annual surplus or deficit and the change in net financial assets (debt);
- reports spending to acquire tangible capital assets and inventories of supplies; and
- reports disposal of tangible capital assets and the use of inventory.

The **Statement of Cash Flow** is a required statement that:

- identifies where cash came from;
- shows how cash was used; and
- provides details on changes in cash and cash equivalents since the previous reporting period.

Notes and Schedules

Supplementary Schedules to municipal financial statements contain additional detailed information for the reader. Although the schedules will vary depending on the size and complexity of the municipal operation there is generally some consistency in form and content.

The **Notes to the Financial Statements** contain important information and explanations, some of which are required by legislation and regulation. The notes highlight various aspects of the financial statements and provide background information and insight on the impacts of specific values in the financial statements. In fact, many users review the notes before examining the main statements.

Typical notes to financial statements include information on:

- accounting policies;
- cash and investments;
- deferred revenue;
- employee benefit obligations;
- debt and debt limit information;
- tangible capital assets; and
- accumulated surplus.

Specimen Financial Statements

Municipal Affairs prepares a specimen financial statement each year for the fictional *Town of New Sampleford* and it forms the basis for this guide as well. It includes the four main statements, supplementary schedules and a comprehensive presentation of typical notes to the financial statements.

The complete Town of New Sampleford financial statement package is available for reference on the Ministry website at:

www.municipalaffairs.gov.ab.ca/documents/ms/2009_New_Sampleford.pdf

Town of New Sampleford
Statement of Financial Position
As at December 31, 2009

	2009 $	2008 $ (Restated)
FINANCIAL ASSETS 1		
Cash and temporary investments (Note #)	**199,000**	69,000
Receivables		
Taxes and grants in place of taxes (Note #)	**73,000**	71,000
Trade and other receivables	**21,000**	30,000
Land for resale inventory	**155,000**	30,000
Investments (Note #)	**280,000**	480,000
Debt charges recoverable (Note #)	**10,000**	11,000
	738,000	691,000
LIABILITIES		
Temporary bank indebtedness 2	**46,000**	---
Accounts payable and accrued liabilities	**140,000**	163,000
Deposit liabilities	**8,000**	7,000
Deferred revenue (Note #)	**56,000**	23,000
Employee benefit obligations (Note #)	**50,000**	40,000
Provision for landfill closure and post-closure costs (Note #)	**20,000**	2,000
Long-term debt (Note #) 3	**2,900,000**	2,701,000
	3,220,000	2,936,000
NET FINANCIAL ASSETS (DEBT)	**(2,482,000)**	(2,245,000)
NON-FINANCIAL ASSETS		
Tangible capital assets (Note #) 4	**7,865,675**	6,854,400
Inventory for consumption	**5,000**	4,000
Prepaid expenses	**1,000**	1,000
	7,871,675	6,859,400
ACCUMULATED SURPLUS (Note #)	**5,389,675**	4,614,400

Statement of Financial Position

The Statement of Financial Position reports on a municipality's assets, liabilities and accumulated surplus. A review of the Statement of Financial Position should be in the context of a long-term view of the municipality's financial health, and not focus solely on how much money is currently in the bank. A reader should consider whether the municipality has the necessary assets to provide future services, and whether there are sufficient future revenues to cover existing liabilities.

A net debt position does not necessarily mean the municipality is in financial difficulty. It is important that a viable debt management plan is in place to ensure that the debt is sufficiently funded and that municipal services are not jeopardized.

1 Financial assets are comprised of cash or items that will eventually be turned into cash. Land for resale and long-term investments are examples of items that will eventually be turned into cash.

2 Temporary bank indebtedness is the total of any unpaid short-term debt (loans, lines of credit or bank overdrafts) that the municipality is required to repay within one year.

3 The amount of long-term debt (usually for capital purposes) is recorded separately from short-term debt. The notes to the financial statements provide important information regarding future debt repayments and how much of the legislated debt limit has been used.

4 The amount recorded for tangible capital assets is the net book value, which is the actual cost less the accumulated amortization.

The accumulated surplus is the primary indicator of the financial resources the municipality has available to provide future services. It consists of both cash and non-cash components. The notes to the financial statements should identify what portions of the accumulated surplus are:

- unrestricted (including cash, accounts receivable and other non-cash financial assets);
- restricted (cash that can only be used for a pre-determined purpose); and
- equity in tangible capital assets.

Town of New Sampleford
Statement of Operations
For the Year Ended December 31, 2009

	Budget $ (Unaudited)	**2009 $**	2008 $ (Restated)
REVENUE			
Net municipal taxes (Schedule 2)	1,425,000	**1,430,000**	1,278,000
User fees and sales of goods	775,000	**760,000**	742,000
Government transfers for operating (Schedule 3) 1	25,000	**27,000**	23,000
Investment income	15,000	**13,000**	15,000
Penalties and costs of taxes	17,000	**20,000**	19,000
Development levies	15,000	**9,000**	25,000
Licenses and permits	8,000	**10,000**	8,000
Other	---	**29,000**	20,000
Total Revenue	2,280,000	**2,298,000**	2,130,000
EXPENSES			
Legislative	55,000	**58,000**	46,000
Administration	165,000	**152,000**	163,000
Bylaws enforcement	30,000	**30,000**	29,000
Roads, streets, walks, lighting	950,000	**926,000**	977,000
Water supply and distribution	425,000	**444,000**	381,000
Wastewater treatment and disposal	74,000	**75,000**	71,000
Waste management	110,000	**106,000**	115,000
Family and community support	110,000	**113,000**	104,000
Land use planning, zoning and development	42,000	**40,000**	38,000
Subdivision land development	75,000	**117,000**	43,000
Parks and recreation	60,000	**60,000**	64,000
Culture	30,000	**30,000**	30,000
Amortization (illustrative only) 2	400,000	**463,725**	428,400
Loss on disposal of capital assets (illustrative only)	---	**8,000**	----
Total Expenses	2,526,000	**2,622,725**	2,489,400
EXCESS (SHORTFALL) OF REVENUE OVER EXPENSES - BEFORE OTHER	(246,000)	**(324,725)**	(359,400)
OTHER			
Contributed assets 3	800,000	**800,000**	---
Government transfers for capital (Schedule 3) 1	300,000	**300,000**	268,000
EXCESS (SHORTFALL) OF REVENUE OVER EXPENSES	854,000	**775,275**	(91,400)
ACCUMULATED SURPLUS, BEGINNING OF YEAR 4	4,614,400	**4,614,400**	4,705,800
ACCUMULATED SURPLUS, END OF YEAR	5,468,400	**5,389,675**	4,614,400

Statement of Operations

The Statement of Operations reports on revenues, expenses and the results for a fiscal year or reporting period. The Statement of Operations provides detailed information on what transactions have impacted the accumulated surplus from the beginning of the year to the end of the year. Non-cash items such as amortization expense and contributed assets are included.

1 Federal and provincial governments provide grants to municipalities for operating and/or capital purposes. These grants are reported on two separate lines: government transfers for operating and government transfers for capital.

2 The amortization expense is a non-cash amount that represents the portion of the historical cost of the municipality's tangible capital assets that is used up during the reporting period. Some municipalities report the amortization expense as a separate line, while others include the amortization expense in the costs of the specific service provided.

3 Contributed assets are normally tangible capital assets that have been donated or transferred to the municipality. Contributed assets are reported as revenue on the Statement of Operations because they create an expected future economic benefit. As a result there is a corresponding increase in the accumulated surplus.

Although contributed assets are reported as revenue, they do not represent cash received by the municipality.

4 The accumulated surplus may increase significantly without a corresponding increase in financial assets. For example, a subdivision turned over to the municipality by a developer would be recorded as contributed asset revenue, which would increase the accumulated surplus amount without any change in financial assets.

Town of New Sampleford
Statement of Change in Net Financial Assets (Debt)
For the Year Ended December 31, 2009

	Budget $ (Unaudited)	**2009** **$**	2008 $ (Restated)
EXCESS (SHORTFALL) OF REVENUES OVER EXPENSES	854,000	**775,275**	(91,400)
Acquisition of tangible capital assets 1	(700,000)	**(693,000)**	(411,000)
Contributed tangible capital assets	(800,000)	**(800,000)**	-
Proceeds on disposal of tangible capital assets	-	**10,000**	-
Amortization of tangible capital assets	400,000	**463,725**	428,400
(Gain) loss on sale of tangible capital assets 2	-	**8,000**	-
	(1,100,000)	**(1,011,275)**	17,400
Acquisition of supplies inventories	(150,000)	**(167,000)**	(146,000)
Acquisition of prepaid assets	(40,000)	**(40,000)**	(35,000)
Use of supplies inventories	150,000	**166,000**	149,000
Use of prepaid assets	40,000	**40,000**	35,000
	-	**(1,000)**	3,000
(INCREASE) DECREASE IN NET DEBT 3	(246,000)	**(237,000)**	(71,000)
NET FINANCIAL ASSETS (DEBT), BEGINNING OF YEAR	(2,245,000)	**(2,245,000)**	(2,174,000)
NET FINANCIAL ASSETS (DEBT), END OF YEAR	(2,491,000)	**(2,482,000)**	(2,245,000)

Statement of Change in Net Financial Assets (Debt)

The Statement of Change in Net Financial Assets (Debt) explains the difference between the annual surplus or deficit and the change in net financial assets (debt). It tracks what the municipality has spent to acquire tangible capital assets and inventories of supplies. It reports on the disposal of tangible capital assets and the use of inventory.

1 Acquisition of tangible capital assets is the amount spent on tangible capital assets in the current year. Funding sources could include cash reserves, property taxes, long-term debt or government transfers.

2 A gain is reported when a tangible capital asset is sold or disposed of and the proceeds are greater than the net book value of the asset. A loss is reported if the proceeds are less than the net book value of the asset.

These amounts are also reported on the Statement of Operations, with a gain reported as revenue and a loss reported as an expense.

3 An increase in the net debt position is most likely the result of the municipality funding capital acquisitions with debt or with financial assets accumulated in a previous year.

A net debt position is not in itself an indicator the municipality is in financial difficulty. See the idea box below for a checklist of questions to consider about the implications of a net debt position.

To assess the impact of a net debt position on the financial health of a municipality, consider:

- Is there a debt management plan in place?
- What is the term of the debt?
- What portion of the municipality’s debt limit does the net debt represent?
- Are the municipality’s financial assets liquid and current?
- What portion, if any, of the municipality’s financial assets are restricted?
- What portion of the net debt is funded by the annual tax levy? By user fees?
- Will projected future revenues be sufficient to pay the net debt?

Town of New Sampleford
Statement of Cash Flow
For the Year Ended December 31, 2009

	2009 $	2008 $ (Restated)
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Excess (shortfall) of revenues over expenses	**775,275**	(91,400)
Non-cash items included in excess (shortfall) of revenues over expenses:		
Amortization of tangible capital assets 1	**463,725**	428,400
Loss on disposal of tangible capital assets	**8,000**	--
Tangible capital assets received as contributions 1	**(800,000)**	-
Non-cash charges to operations (net change):		
Decrease (increase) in taxes and grants in lieu receivable	**(2,000)**	10,000
Decrease (increase) in trade and other receivables	**9,000**	(1,000)
Decrease (increase) in land held for resale	**(125,000)**	-
Decrease (increase) in inventory for consumption	**(1,000)**	2,000
Decrease (increase) in prepaid expenses	**-**	(1,000)
Increase (decrease) in accounts payable and accrued liabilities	**(23,000)**	2,000
Increase (decrease) in deposit liabilities	**1,000**	-
Increase (decrease) in deferred revenue	**33,000**	-
Increase (decrease) in employee benefit obligations	**10,000**	-
Increase (decrease) in provision for landfill closure/post-closure	**18,000**	2,000
Cash provided by operating transactions	**367,000**	351,000
CAPITAL		
Acquisition of tangible capital assets 2	**(693,000)**	(411,000)
Sale of tangible capital assets	**10,000**	-
Cash applied to capital transactions	**(683,000)**	(411,000)
INVESTING		
Decrease (increase) in restricted cash or cash equivalents	**(35,000)**	-
Decrease (increase) in investments	**200,000**	(50,000)
Cash provided by (applied to) investing transactions	**165,000**	(50,000)
FINANCING		
Debt charges recovered 2	**1,000**	1,000
Long-term debt issued	**300,000**	-
Long-term debt repaid	**(101,000)**	(101,000)
Cash provided by (applied to) financing transactions	**200,000**	(100,000)
CHANGE IN CASH AND EQUIVALENTS DURING THE YEAR	**49,000**	(210,000)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**69,000**	279,000
CASH AND CASH EQUIVALENTS, END OF YEAR	**118,000**	69,000

Statement of Cash Flow

The Statement of Cash Flow identifies where cash came from, shows how cash was used, and provides details on changes to cash and cash equivalents since the last reporting period.

1 The Statement of Cash Flow begins with the net results of municipal operations. This operational result includes amortization, which is a non-cash expense. To determine the change in the municipality's cash position, the amortization amount is added back into the operations result.

On the other hand, the value of tangible capital assets contributed is reflected as non-cash revenue in the Statement of Operations. To determine the change in the municipality's cash position, this amount is deducted from the operations result.

2 The Capital and Financing categories provide a summary of the capital transactions that took place and an indicator of what portion of the capital transactions were financed with long-term debt.

The Capital section provides information on the amount the municipality expended on tangible capital assets as well as the amount the municipality received from selling tangible capital assets during the reporting period.

The Financing section identifies funds received from long-term debt financing, as well as the amount of long-term debt principal repaid during the reporting period.

The Statement of Cash Flow provides detailed information on significant cash transactions that are not included in the Statement of Operations.

Financial Statement Review Questions

- ☐ Are there long-range planning or budgetary issues the municipality needs to address? Financial indicators of concern may include:
  - ☐ a continued increase in the net debt
  - ☐ a restricted surplus not fully supported by financial assets;
  - ☐ a high level of short-term debt indicating working capital position is insufficient; or
  - ☐ a low net book value of tangible capital assets indicating useful life nearing an end.
- ☐ Are there some "red flags" in the financial statements? Potential red flags may include:
  - ☐ a significant decrease in the municipality's cash position from the previous year;
  - ☐ a restricted surplus that exceeds the amount of cash and cash equivalents
  - ☐ a significant decrease in the net financial assets from the previous year;
  - ☐ a significant increase in net debt from the previous year; or
  - ☐ the unrestricted portion of the accumulated surplus is in a deficit position.
- ☐ Have there been any extraordinary or unusual financial transactions that may have future implications for the municipality?
- ☐ How did the current year's financial decisions and operations impact the overall financial position of the municipality?
  - ☐ What are the costs of providing specific services?
  - ☐ What services have full or partial cost recovery associated with them?
  - ☐ What is the cash position and debt level?
  - ☐ Are there adequate operating and capital funds for future projects, or will borrowing be required?
- ☐ Does the municipality have sufficient working capital?
  - ☐ Is short term borrowing required before property tax revenues are received?
- ☐ What is the remaining useful life of the municipality's tangible capital assets?
  - ☐ What are the financial and budgetary impacts of replacing or rehabilitating tangible capital assets nearing the end of their life?
- ☐ What is the content of the auditor's management letter?
  - ☐ Is there a clean audit report?
  - ☐ Are there any items of concern that need to be mitigated or addressed?
- ☐ Have the municipality's financial statements been sufficiently communicated to the residents and businesses in the municipality?

Glossary of Terms

Amortization – the systematic allocation of the historical cost of a tangible capital asset over its useful life.

Accumulated Amortization – the total amortization pertaining to a tangible capital asset from the time the asset was placed into service until the date of the financial statement.

Consolidated Financial Statements – statements containing financial information for the municipality and its owned or controlled organizations (e.g., fire, utilities, library).

Construction in Progress – tangible capital assets under construction at the end of the fiscal year that have not been put into service (e.g., engineered structures, buildings, land improvements).

Contributed Assets – assets that have been transferred or donated to the municipality and that will provide a future economic benefit.

Deferred Revenue – income received that will not be recorded as revenue until certain transactions or events take place.

Equity in Tangible Capital Assets – the net book value of recorded tangible capital assets less capital debt.

Expenditure – an outlay of cash.

Expense – a cash or non-cash cost (e.g., wages, materials, amortization).

Financial Assets –current cash resources plus any items or holdings that are expected to be converted into cash in the future.

Gain or Loss on Sale – proceeds from the sale of a tangible capital asset that are greater than (gain) or less than (loss), the net book value of the asset.

Government Transfers – entitlements, transfers under cost-share agreements, and/or grants from other levels of government.

Net Book Value – the total cost of a tangible capital asset minus the accumulated amortization and any write-down of the asset.

Net Financial Assets (Debt) – an amount equal to the total financial assets less the total liabilities.

Restricted Surplus– the amount that results from excess revenues which have been internally designated for a specified future purpose, or externally restricted.

Tangible Capital Assets – non-financial assets having a physical substance that are held for use in the supply of goods and services, have economic lives beyond the accounting period, are used on a continuing basis and are not for sale in the ordinary course of operations.

Unrestricted Surplus - the portion of the accumulated surplus that results from excess revenue and expenses available for any future use.

Working Capital - the excess of current assets minus current liabilities. Positive working capital indicates an ability to meet short term obligations.