Intelligence MEMOS

From: William B.P. Robson

To: Canada's City Councillors and Managers

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Re: **Does Accounting Drive Budget Decisions? The Strange Case of the Toronto Subway "Upload"**

Should Canadian cities budget using the same accounting they use in their financial statements? In particular, should they amortize capital – recording expenses related to capital investments over time, as the assets deliver their services – in their budgets?

The C.D. Howe Institute's ongoing project on municipal fiscal transparency and accountability has repeatedly said they should. They already do in their financial statements. But cities typically show cash outlays on long-lived infrastructure such as public transit in their budgets – which makes them look unaffordable, or at least unfair to current taxpayers. Provinces amortize capital in their budgets, as do the feds, businesses and not-for-profits. So should cities.

Many municipal officials disagree. Some objections are variations on the bureaucratic classic: "we've always done it this way, so we always must." Some are intriguing: "amortizing capital would make it look cheap – councillors would want to spend even more." Some are helpless: "The province won't let us." And some seem like common sense: "reality is what matters – accounting doesn't drive decisions!"

Not so: what seems like common sense can be wrong. Accounting does indeed drive decisions. For better or for worse, numbers shape understanding, and therefore actions.

A current case in point: the province of Ontario's impending takeover of Toronto's subways. Many Toronto residents, city representatives and transit experts think the subway upload will compromise service quality and local autonomy.

So why do it? Because Toronto budgets on a cash basis. Upfront outlays for subways are huge – as are provincial subsidies to offset them. If the province owns the subways, and amortizes investments in its budget, they will look cheaper.

If that motivation sounds silly – not common sense – here is what 2019 provincial budget says about it on page 65: "Under municipal ownership, provincial contributions to the city would have had an adverse effect on the province's books, whereas provincial ownership of the assets would allow the province to amortize its capital contributions … [which] creates the fiscal space to allow the province to significantly deepen its commitment to transit…."

Moving the asset from the government that budgets capital on a cash basis to the government that amortizes is the crux of the decision, no matter the impact on integration with buses and streetcars, coordinating transit investment with municipal land-use and development, or accountability to local users.

Will the province follow through? The upload is not uniformly popular. Ontario has already been spending heavily on capital, and has debt to match. The subway asset comes with big deferred-maintenance liabilities. There's a straightforward alternative: providing subsidies equal to the anticipated amortization expense in the provincial budget would be just as helpful to the province's bottom line.

But that last approach would look inadequate next to the massive cash outlays in Toronto's capital budget. As matters stand, big up-front outlays appear to require big up-front provincial subsidies. If – and it's a debatable point – the province really prevents Toronto amortizing capital in the city budget, Ontario can change that requirement. That would be easy – especially compared to the hassle of running Toronto's subway.

All Canadian cities, including Toronto, should amortize capital in their budgets. Their budgets would match their financial statement, which *is* common sense. And budgeting that way would support more, and better, infrastructure investments. Because – as Ontario's potential takeover of the Toronto subway proves – accounting does drive decisions. For better, or for worse.

William B.P. Robson is President and CEO of the C.D. Howe Institute and was a member of the City of Toronto/TTC expert advisory panel on transit.

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