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Two Sets of Books at City Hall? Grading the Financial Reports of Canada's Cities

Annual budgets in most of Canada's major cities are a mess – excluding key activities, using inconsistent accounting, burying crucial numbers where only experts can find them, and often voted well after the fiscal year has started. While some cities have raised their games, cities can improve transparency and accountability by presenting better budgets that city council and citizens can understand.

Benjamin Dachis, William B.P. Robson and Jennifer Y. Tsao

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Daniel Schwanen
Vice President, Research

About The Authors

Benjamin Dachis
is Associate Director, Research, at the C.D. Howe Institute.

William B.P. Robson
is President and CEO of the C.D. Howe Institute.

Jennifer Y. Tsao
is a Researcher at the C.D. Howe Institute.

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The Study In Brief

In nearly all Canada's larger cities, obscure financial reports – notably inconsistent presentations of key numbers in budgets and end-of-year financial reports – hamper legislators, ratepayers and voters seeking to hold their municipal governments to account. Simple questions like "How much does your municipal government plan to spend this year?" or "How much did it spend last year?" are hard or impossible for a non-expert citizen or councilor to answer.

By presenting net rather than gross figures in their budgets, most cities understate their revenue and spending and obscure key activities. The differences in accounting methods in most cities' budgets as compared to the presentations of their financial results are large, and have real-world consequences. By using cash rather than accrual accounting, cities exaggerate the costs of investments in infrastructure, hide the cost of pension obligations, and make it hard to match the costs and benefits of municipal activities to taxpayers and citizens. Moreover, many cities present their budgets late, after significant money has already been committed or spent, do not publish their financial results in a timely way, and bury key numbers deep in their reports.

This report grades the financial presentations of major cities in Canada in their most recent budgets and financial reports. Toronto and Winnipeg are at the bottom, with Fs. In addition to approving their budgets many weeks after their fiscal years had started, these cities provide little information in reader-friendly form. More happily, the cities of Brampton, Calgary, Halifax, Halton and Vancouver garner higher marks.

Our key recommendations are that municipal governments should present their annual budgets on the same accounting basis as their financial statements, and that budgets should show gross, not net, revenue and spending figures. Budgets should use accrual accounting, recording revenues and expenses as the relevant activities occur over time. Provincial governments exercise decisive control over cities, so those that impede accrual-based budgets at the municipal level should stop doing so. Now is an opportune time for this change: major reviews of the acts governing municipalities are nearly complete in Alberta and Ontario. Even in cases where a province is the impediment, cities can release the relevant information on their own – and they should.

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How much does your municipal government plan to spend this year? How much did it spend last year? How does what it spent last year compare to what it said it would spend?

These should be simple questions for taxpayers, councillors and local media to answer. But in every major Canadian city, finding the answers is anything but. The unsatisfactory nature of municipal financial reporting is a serious problem, and not only for accountants. Inconsistent presentations and dense budget books hamper the ability of legislators, ratepayers and voters to hold their municipal governments to account.

The differences between how cities present their budget documents and how they report their results at year-end have real-world consequences. Municipal budgets understate the size of municipal operations, obscure key activities, exaggerate the costs of investments, hide the cost of pension obligations, and make unclear the sustainability of city finances over time.

At the beginning of the 2000s, the federal government and all the provincial and territorial governments used different methods of accounting and presentation in their budgets than they did in their financial reports. Over time, thankfully, those differences are disappearing. This review of Canadian cities' fiscal reporting shows how local governments can and should move forward and improve their accountability for the money they raise and spend.

Our key recommendation – as we have argued before (Dachis and Robson 2011, 2014, 2015) – is that municipal governments should present their annual budgets on the same accounting basis as their financial statements. Budgets should show gross, not net, revenue and spending figures. Budgets should use accrual accounting, recording revenues and expenses as the relevant activities occur over time, not in one fell swoop. Provincial governments exercise decisive control over cities, so those that impede accrual-based budgets at the municipal level should stop doing so. Now is an opportune time for this change: major reviews of the acts governing municipalities are nearly complete in Alberta and Ontario. Even where provinces are impediments, however, cities can release the relevant information on their own – and they should.

Municipal accounting practices may sound arcane, but they matter in reality. Current practices likely bias decisions against investing in, and paying for, long-lived assets. Accrual-based budgeting would give councillors and voters new insights about how to pay for, and maintain, infrastructure investments. Moreover, cash budgets encourage cities to neglect future pension liabilities. And inconsistent budgeting among different levels of government obscures useful comparisons. Better accounting would give everyone a clearer picture – especially important if cities are to get new tax powers or direct financial support.

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Municipal Budgets and Financial Reports

Public sector accountability has many dimensions: actual and potential reports range from on-time performance of public transit, to how well students and patients fare in public schools and hospitals, and to audits of spending in government agencies. Our focus is municipal governments' annual fiscal footprint: their aggregate revenue and spending in a fiscal year. A municipality's fiscal footprint determines the taxes, user fees and other charges that citizens and businesses must pay, and is a critical element in assessing its public services and impact on the local economy.

Like the federal and provincial governments, Canadian cities produce two major documents in their annual fiscal cycles: budgets and financial reports. Budgets contain municipalities' fiscal plans at the start of the year. Budgets take months of preparation and are the principal opportunity for citizens, their elected representatives and the media to consider and provide input on municipal priorities. In most cases, cities present a capital budget for long-term investments, and an operating budget that is subject to a provincial requirement for annual balance.

Audited financial reports show what cities actually raised and spent during the year. Under Public Sector Accounting Board (PSAB) rules, all cities must present their financial statements on a standardized basis. This common accounting provides largely comparable measures of municipal finances, with taxpayers, the media and councillors getting additional comfort from certification by external auditors. To be useful to these various constituencies, including allowing them to compare results to intentions, budgets and financial reports need to meet some key criteria.

Grading Municipal Financial Presentations

A city's financial documents must be clear to a non-expert, time-constrained reader. Cumbersome budgets that do not clearly display the spending promises of city governments will make it hard for councillors to know what they are voting, and for citizens to know what promises were made. The same is true, retrospectively, for financial reports.

To help the non-expert reader quickly compare key revenue and spending totals, municipal financial documents should have the following characteristics:

Present the headline spending figures early and prominently: Even an expert reader may have problems finding and adding multiple spending figures scattered throughout financial documents. A non-expert will have no chance. Budgets that present the key spending totals deep in the document do few favours to readers looking to understand how much their city is spending. Accordingly, we judge only the merits of the most prominently displayed aggregate figures in the most prominently displayed documents posted on a municipality's website.

Present the previous year's spending amount in budgets: Many municipal budgets present the spending amount that council approved for the current year without the context of what city council approved – or what the city is likely to have actually spent – in the previous year. The lack of previous-year reference points is especially pervasive in capital budgets: cities typically do not show intentions or actuals for past capital projects when deciding on future ones.

Show combined rate- and tax-supported gross expenditures: A pervasive problem in city financial documents is presentations that show the spending of a department, or the city as whole, net of any non-property tax revenue they collect.

"Tax-supported" services attract more attention than "rate-supported" services such as water and sewage or other activities for which cities charge user fees, since homeowners and businesses typically consider rate-supported items as akin to a priced service, possibly one they can control by varying their use. Property taxes are more of an imposition outside the taxpayer's control. But while this distinction might justify showing net amounts as supplementary information in budgets and financial reports, highlighting net rather than gross figures – or, worse, not showing gross figures at all – understates a government's fiscal footprint. Cities that present multiple bottom lines impede understanding of how much their city spends.

Reconcile results to budget projections, as originally reported, in the financial report: Even when accounting and gross reporting are consistent, it helps to have reconciliation tables in financial reports that itemize how actual expenses deviated from the numbers presented in the budget. For their part, Canada's senior governments increasingly show these reconciliations, which help legislators and citizens hold governments to account for their actions and, potentially, take steps to reduce the size of future surprises. When accounting and gross/net reporting are inconsistent, such reconciliation tables are critical.

Present budgets and financial reports on a timely basis: Budgets are the cornerstone documents that lay out a municipality's plan over the course of the coming year. A budget presented well into the fiscal year in which it applies asks councillors to approve spending that has already happened – a clear violation of accountability. Councillors should vote the budget before – at least no later than – the start of the fiscal year. Similarly, cities should publish their audited financial statements as soon as possible. Identifying where budget plans did not fit reality is important to determine as soon as possible, and delays in publishing financial reports can result in problems persisting.

Present budgets and financial reports on the same accounting basis: If an organization uses inconsistent accounting in preparing its budgets and its financial reports, people will not be able to tell whether its revenue and spending were close to budget, or far from it – or in which direction. The same goes for individual categories of revenue and spending: simple questions such as whether property-tax revenue came in above or below target, or whether the city over- or under-shot its budget for policing, can be impossible for councillors, media, taxpayers or citizens to answer.

How Good are Your City's Practices?

Ideally, we would look at both the revenue and spending sides of municipal budgets and financial reports. Unfortunately, the accounting on the revenue side of budgets is so fraught with problems – municipalities combine borrowing with tax and other revenues in their capital budgets, which makes no economic sense – that we limit our investigation to spending.

The quality of municipal presentations differs in important ways. We create a letter grade for each city based on the above criteria. We also present a score range for each criterion, as presenting some information in some criteria deserves a higher grade than presenting no information. However, only ideal presentations receive a top grade. For example:

- We ask whether cities present the previous year's budgeted amount or an estimation of the actual amount spent in their headline presentation. We give a score of 0 if cities do not present the previous year's spending for either operating or capital. We give a score of 1 for at least presenting the totals of the previous year's operating budget, and a score of 2 for presenting the previous year's amount on either a consolidated basis or as the totals for each of the operating and capital budgets.
- We give no marks to a city that only presents its net expenditures as its main headline presentation, or does not consolidate utilities with

tax-supported operating expense in its headline expense. We give 1 mark for a budget that presents net and gross expenditures with equal prominence and 2 marks for a city that presents gross expenditures as the headline measure.

- If there is a budget reconciliation table in last year's financial reports, we provide 1 mark for an attempt at a table that reconciles the financial statements to the budget, even when the budget figures in the reconciliation table are different from those that appeared in the budget itself.[1] We give 2 marks for a reconciliation table that has at least one of capital or operating amounts from the budget replicated in a reconciliation table, even if the reconciliation has only limited information on the reasons for deviations. We give full marks for a fulsome description of the reasons for spending deviations.

Canada's Best and Worst Cities for Financial Reporting

The quality of municipal financial reports varies greatly across 25 large cities in Canada we examine (Table 1).[2] Toronto and Winnipeg stand out, and not in a good way. In addition to approving their budgets many weeks after their fiscal years had started, these two cities provide little information in reader-friendly form. Key totals are buried deep in their documents.[3] Toronto also does not publish its end-of-year financial reports until well into the next fiscal year. Neither city presents its budget on the same accounting basis as its financial report. Toronto's reconciliation table contains budget numbers that do not match the numbers in the budget itself, and Winnipeg does not present a reconciliation table at all. Winnipeg also presents its tax-supported and rate-supported budgets separately, which understates the overall size of the city's fiscal impact. For these reasons, we give both Winnipeg and Toronto an "F" on quality of presentation.

The poor quality of financial reports from Durham Region, Saskatoon and Windsor also deserve mention. The operating figure presented prominently within the first few pages of the budgets of these cities excludes operating expenses for certain areas of municipal services.

At the other end of the spectrum, the cities of Brampton, Calgary, Halifax, Halton and Vancouver stand out for clear presentations. Notably, Brampton has gone some distance toward presenting its budget on the same accounting basis as its financial report.[4] Unfortunately, it has not gone all the way: it only presents its accrual-based budget as supplementary information. Brampton, Calgary, Halifax, Halton and Vancouver also stand out for approving their budgets before the start of the year and their financial statements quickly, presenting useful reconciliations between budgets and financial reports, and showing single gross expenditure totals as the overall fiscal footprint of their cities.

Understanding Municipal Accounting

The appropriateness of cash accounting in budgets is among the most contentious issues in municipal budgeting – as reflected in the poor marks virtually across the board on the criterion of consistent accounting in budgets and financial reports. The best way to represent economic reality in financial reports is a subject of ongoing and energetic debate.

1 Our score for a reconciliation table compares 2015 financial statements to the 2015 budget.

2 Our analysis covers cities with a population of more than 275,000 or total reported revenue of more than $500 million in 2011, and for which continuous data were available.

3 In order to produce a consistent measure of the page number on which cities present their headline totals, our measure is the page of the PDF document that is the most prominently displayed budget document on the city's website.

4 We are glad to note that Brampton has improved after having scored particularly poorly in previous iterations of this report.

Table 1: Canadian Municipal Financial Presentation Scorecard

Municipality	Latest Budget Approval Date	Budget Approval Date: Late or Early?	Page Number of Headline Total Figure (Operating + Capital)	Reconciliation Table Explaining Differences in Total	Comparison of Budget Projections to Previous Year's Totals	Does Budget Present City-wide Gross or Net Expenditures or Both as Headline Expenditure?	How Long after Fiscal Year End are Financial Reports Approved?	Budget on Same Basis of Accounting as Financial Report? (Y/N)	Overall Grade
Grading Weight (Scoring)	3 (3 if early, 2 less than 4 weeks late, 1 less than 8 weeks late, 0 otherwise)		4 (3: operating total on first 15 pages, 2: first 15-30 pages; 1: 30-50 pages, 0: 50+ pages). Extra point if capital and operating on same page of same document.	3 (3 for full, 2 for at least one of cap/op. matching, 1 for a reconciliation, but when numbers do not match, 0 for none)	2 (2 if both capital and operating restated, 1 if one restated, 0 if not all)	2 (2 if gross only, 1 if net and gross equal prominence, 0 if net)	2 (2 if within 4 months of year-end, 1 if published 5-6 months after, 0 if 7 months)	4 (4 if budgets and audited statements on same basis, 2 if information supplemental, 0 otherwise)	20 (A: >13, B:11-13, C: 8-10, D: 5-7 F: <5)
Brampton	December 9, 2015	3 weeks early	Operating: p. 3 out of 32; Capital: p. 3 out of 19	2	1	Gross	6 months (June 3)	Partial***	A- (14)
Calgary	November 24, 2014	5 weeks early	Operating: p. 8 out of 129; Capital: p. 34 out of 129	3	2	Both	4 months (April 25)	No	A- (14)
Durham	February 17, 2016	6 weeks late	Operating: p. 3 out of 297; Capital: p. 4 out of 297	1	1	Net	6 months (June 30)	No	D+ (7)
Edmonton	December 3, 2015	4 weeks early	Operating: p. 40 out of 103; Capital: p. 51 out of 103	0	2	Net	4 months (April 19)	No	C- (8)
Greater Sudbury	February 9, 2016	5 weeks late	Operating: p. 2 out of 47; Capital: p. 21 out of 47	2	2	Gross	6 months (June 28)	No	B- (11)
Halifax	March 8, 2016	3 weeks early	Operating: p. 5 out of 344: Capital: p. 4 out of 181	3	1	Gross	2 months (July 19)	No	A- (14)
Halton	December 16, 2015	2 weeks early	Operating and Capital both: p. 26 out of 624	3	2	Gross	5 months (May 18)	No	A- (14)
Hamilton	March 9, 2016	9 weeks late	Operating and Capital both: p. 5 out of 55	3	1	Gross	6 months (June 8)	No	B- (11)

Grade is for 2016 annual budget. Halifax grade is for proposed 2016-2017 budget. Calgary grade is for 2015-2018 budget. *Common accounting between budget and financial statements is only on non-audited statistics presented prominently in Montreal's financial statement. **The reconciliation table is not of gross spending, but to explain the net surplus on PSAB standard. ***City presents budget on a full accrual basis only as supplementary information, not as the headline budget figure.

Source: Authors' calculations from municipal financial documents.

Table 1: Continued

Municipality	Latest Budget Approval Date	Budget Approval Date: Late or Early?	Page Number of Headline Total Figure (Operating + Capital)	Reconciliation Table Explaining Differences in Total	Comparison of Budget Projections to Previous Year's Totals	Does Budget Present City-wide Gross or Net Expenditures or Both as Headline Expenditure?	How Long after Fiscal Year End are Financial Reports Approved?	Budget on Same Basis of Accounting as Financial Report? (Y/N)	Overall Grade
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London	March 10, 2016	9 weeks late	Operating: p. 7 out of 286; Capital: p. 10 out of 286	1**	1	Gross	6 months (June 23)	No	C- (8)
Markham	December 15, 2015	2 weeks early	Operating and Capital both: p. 5 out of 393	0	1	Gross	4 months (April 22)	No	B (12)
Mississauga	December 9, 2015	3 weeks early	Operating: p. 10 out of 770; Capital: p. 45 out of 770	2	1	Both	4 months (April 14)	No	B (12)
Montréal	December 10, 2015	3 weeks early	Operating: p. 37 out of 350; Capital: p. 20 out of 130	0	1	Gross	4 months (April 13)	Partial*	B- (11)
Niagara	December 3, 2015	4 weeks early	No single prominent document, only website presentation	3	2	Net	6 months (June 27)	Partial***	B- (11)
Ottawa	December 9, 2015	3 weeks early	Operating: p. 11 out of 177; Capital: p. 22 out of 177	3	2	Both	6 months (June 8)	No	B+ (13)
Peel	December 3, 2015	4 weeks early	Operating and Capital both: p. 7 out of 391	3	0	Both	6 months (June 2)	No	B (12)
Quebec City	December 7, 2015	4 weeks early	Operating: p. 20 out of 188; p. 27 out of 188	0	1	Net	5 months (May 12)	Partial***	C (9)
Saskatoon	December 1, 2015	4 weeks early	Operating: p. 10 out of 296; Capital: p. 11 out of 296	0	1	Net	7 months (July 19)	No	D+ (7)

Grade is for 2016 annual budget. *Common accounting between budget and financial statements is only on non-audited statistics presented prominently in Montreal's financial statement. **The reconciliation table is not of gross spending, but to explain the net surplus on PSAB standard. ***City presents budget on a full accrual basis only as supplementary information, not as the headline budget figure.
Source: Authors' calculations from municipal financial documents.

Table 1: Continued

Municipality	Latest Budget Approval Date	Budget Approval Date: Late or Early?	Page Number of Headline Total Figure (Operating + Capital)	Reconciliation Table Explaining Differences in Total	Comparison of Budget Projections to Previous Year's Totals	Does Budget Present City-wide Gross or Net Expenditures or Both as Headline Expenditure?	How Long after Fiscal Year End are Financial Reports Approved?	Budget on Same Basis of Accounting as Financial Report? (Y/N)	Overall Grade
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Surrey	March 7, 2016	9 weeks late	Operating and Capital both: p. 74 out of 352	1	2	Gross	5 months (May 9)	Yes	B- (11)
Toronto	February 17, 2016	6 weeks late	Operating: p. 96 out of 1024; Capital: p. 130 out of 1024	1	1	Both	7 months (July 13)	No	F (4)
Vancouver	December 15, 2015	2 weeks early	Operating: p. 7 of 348; Capital: p. 8 of 348	2	2	Gross	3 months (March 31)	No	A- (14)
Vaughan	December 15, 2015	2 weeks early	Operating: p. 5 out of 303; Capital: p. 43 out of 303	2	0	Gross	6 months (June 7)	No	B- (11)
Waterloo	January 13, 2016	2 weeks late	Operating and Capital both: p. 10 out of 287	1**	0	Gross	5 months (May 11)	No	C+ (10)
Windsor	December 21, 2015	2 weeks early	Operating: p. 8 out of 221; Capital: p. 4 out of 455	0	1	Net	8 months (August 22)	No	D+ (7)
Winnipeg	March 22, 2016	11 weeks late	Operating: p. 31 out of 287; Capital: p. 48 out of 287	0	1	Net	5 months (May 11)	No	F (3)
York	December 17, 2015	2 weeks early	Operating and Capital both: p. 4 out of 381	2	1	Gross	5 months (May 11)	No	B+ (13)

Grade is for 2016 annual budget. *Common accounting between budget and financial statements is only on non-audited statistics presented prominently in Montreal's financial statement. **The reconciliation table is not of gross spending, but to explain the net surplus on PSAB standard. ***City presents budget on a full accrual basis only as supplementary information, not as the headline budget figure.
Source: Authors' calculations from municipal financial documents.

Accrual accounting, which has is now common practice – and is now used in municipal end-of-year financial statements but not comprehensively in budgets – says that financial reports should anticipate, or report, revenues and expenditures during the period when the relevant activity occurs.

A salient example, one that is highly relevant to cities, is the purchase of a long-lived asset such as a building. It makes no sense to record the entire construction cost as an expense at the time the cash is laid out. More sensible is to record the value of the building as an asset and amortize the expense – writing it off as the building delivers its services – which brings the cost of the building into annual spending over time.[5]

Municipal governments have large capital assets – buildings, as well as equipment and infrastructure such as roads, bridges, and water and sewage facilities. Their financial reports do not record the entire cost of these items as expenses in the year of the cash outlay, but show the annual amortization over their useful lives. Among other virtues, this approach helps match the period during which taxpayers cover the cost of long-lived assets with the period during which the assets provide services, a straightforward tool to achieve fairness among taxpayers over time.

The PSAB has required accrual accounting by Canadian governments since 2009. These standards are not ideal for all purposes. Some problems arose in the transition to accrual accounting: for example, cities need information on the historical value of assets to calculate amortization, and that information was not always available.

A notable gap in public sector accounting standards is the omission of the full cost of employee benefits earned but not yet paid, especially pension obligations.[6] Such gaps reduce the value of annual income statements and associated statements of net worth in determining how well a government is matching its revenues to its expenditures and avoiding unfair transfers of wealth over time. Because existing accrual accounting does a better job in this regard than alternatives such as cash accounting, however, and its embodiment in current standards signifies widespread acceptance, we accept the PSAB methodology as definitive for this evaluation.

A simple example shows how current municipal budgets put future taxpayers at risk of paying large pension obligations, but can result in current taxpayers overpaying for upfront-financed infrastructure (Box 1).

Most municipalities use accrual accounting only in parts of their budgets, such as accounts receivable. They use cash accounting elsewhere, most notably for capital items. A common practice is to show these expected cash outlays in a "capital" budget, while also producing an "operating" budget for items to be consumed and expensed during the year. Some municipalities present and vote capital and operating budgets together; others do so separately. Either way, the resulting amounts are not comparable to what will appear in financial reports.

This discrepancy not only complicates comparisons of spending in budgets and financial reports, it makes comparing revenue in the two documents largely pointless. "Capital financing" in

5 In addition to statements of operations, which show annual flows, and statements of financial position, which show assets and liabilities at a point in time, modern financial reports include a third presentation showing changes in cash, which allows a user to reconcile accrual-based concepts with flows of cash in and out.

6 As Robson and Laurin (2016) note, the interest rate that the federal government uses to discount future pension liabilities does not provide an economically meaningful estimate of the present value of future pension payment obligations.

Box 1: Cash Versus Accrual Accounting in Metropolis

Metropolis, a hypothetical city, has three kinds of expenses: $100 in annual operating expenses such as office supplies, salaries, and so on; a one-time $100 subway infrastructure project built this year that will benefit users over the next five years before it needs to be replaced; and $50 in pension and healthcare promises it agreed to with current employees that it will begin to pay in five years. Metropolis finances all annual operating costs with $100 from property taxes and receives $100 in a one-time, higher-level government transfer, which it decides to use to finance the subway. We show Metropolis's budget on a cash basis and on an accrual basis.

Metropolis's Budget: Cash versus Accrual

Year	Revenues	Expenses: Cash Accounting				Expenses: Accrual Accounting	
		Operating Expenses	Capital Expenses	Pension Expenses	Balance	Consolidated Expenses	Balance
1	$100 $100	$100	$100	$0	$0	$130	+$70
2	$100	$100	$0	$0	$0	$130	-$30
3	$100	$100	$0	$0	$0	$130	-$30
4	$100	$100	$0	$0	$0	$130	-$30
5	$100 $50	$100	$0	$50	$0	$130	$20
Total	**$650**	**$500**	**$100**	**$50**	**$0**	**$650**	**$0**

Source: Authors' example.

Box 1: Continued

Under cash accounting, Metropolis easily runs a balanced budget in the first four years with revenues from annual property taxes and transfers. It used the grant from the higher level government to pay for the subway. Taxpayers – who ultimately fund the higher government transfers – in year 1 financed the whole cost of the subway that benefits taxpayers over the next five years. However, in year 5, when pension obligations come due, Metropolis must find $50 that its cash budgets in previous years missed. Taxpayers in year 5 will pay for the benefits that taxpayers in years 1 through 4 received from the work of municipal employees. Cash accounting obscures the costs and benefits from long-term commitments and the comparison of annual costs and benefits.

If Metropolis budgeted on an accrual basis, its consolidated expenses would show the annual share of the combined operating, capital and pension cost to taxpayers in the year the relevant events occurred. Its accrual budget would include the same annual operating cost as the cash budget, plus one-fifth of the infrastructure outlays in year one and one-fifth of the pension outlays due in year five. The accrual method highlights the intergenerational inequity – the surpluses of $70 in year 1 and $20 in year 5, and the deficits in years 2 through 4 – created by cash accounting that relies on taxpayers in year 1 to finance infrastructure and taxpayers in year 5 to finance pensions and health benefits. Accrual budgeting might lead Metropolis to finance the subway, not from upfront grants, but from user charges over the life of the assets, and to pre-fund its pension obligations as they accrued. If it did, its budget, on an accrual basis, would be balanced each year.

municipal capital budgets includes all sources of funds: not just tax and other current revenue such as grants from other levels of government which do add to net worth, but also funds raised by issuing debt, which do not. This confusion will frustrate even a person familiar with financial reporting who wants to determine the magnitude of a municipality's claim on community resources.

How Much did Your City Spend Last Year?

Having noted the difficulty of comparing spending as presented in municipal budgets and as presented in year-end financial reports, we proceed to show what a reasonably smart and motivated, but non-expert, user of these documents might conclude from an attempt to do so. Table 3 shows the numbers that this person would likely take to be the spending totals in each document – which in most cases involves adding the capital and operating budget totals when a city presents the two separately, as this non-expert user might reasonably conclude that the total of the two represents the overall fiscal footprint of the city.[7] As we mentioned earlier, we do not examine revenue figures as the municipal budget practice of mixing debt financing with tax and transfer revenues makes comparing revenues as presented in budgets and financial reports especially hard.

The differences in spending totals between the budgets and financial reports would prevent our idealized reader from making a meaningful

7 We do not account for transfers between capital and operating budgets.

comparison. For example, the City of Calgary approved a budget – on a cash basis – showing $6.2 billion in spending. Its end-of-year financial report – on an accrual basis – by contrast, showed $3.6 billion in spending. This gap is so large that an expert would hesitate to attribute it to over- or under-spending relative to budget targets – but a non-expert might draw that conclusion. Calgary's financial statements and budgets have the largest percentage difference. Other cities – such as York and Halton Regions – would also lead this reader to conclude that their results were off by more than 50 percent.

To be clear, the differences in Table 2 are not necessarily a reflection of cities over- or under-spending relative to their budget commitments. A non-expert reader cannot get information to allow judgements about over- or under-spending from their financial presentations. Instead, we have a measure dominated by accounting differences between budgets and financial reports.

Accounting Matters when Measuring Fiscal Health

Municipalities' flawed presentations not only mess up comparisons of budgets and financial results, they likely affect city decisions. In particular, too much focus on cash outlays complicates councillors' ability to manage the inevitable tension between the desires and interests of current taxpayers and users of municipal services and those of future taxpayers and service users, notably in building and financing long-lived assets.

Decisions about how to finance assets are not necessarily linked to decisions about how to represent them in financial statements. But as Box 1 illustrated, accrual accounting's basis for good decision-making is clear in a situation where a government borrows, say, $1 billion to finance an asset that will produce services for 20 years, and amortizes the loan over the same 20-year period over which it writes off the asset. That approach straightforwardly tries to match costs and benefits over time.

Presenting councillors with capital budgets that show outlays on such assets as in-year expenses (as cash budgeting does), rather than capitalizing them and amortizing them as they deliver their services (as accrual accounting does), likely leads municipalities to turn down some capital projects they would otherwise approve. Cash budgets may then compel cities to finance the ones they do approve by raising revenues up front even though the project will yield benefits well into the future.

One prominent example is the infrastructure charges municipalities impose on developers. Development charges are one of the main sources of capital financing of municipal capital assets. Ontario municipalities collected $1.9 billion in development charges in 2014.[8] These charges might make sense if they allocated costs across people and across time in proportion to enjoyment of the related benefits (see Bird, Slack, and Tassonyi 2012). But cash-based budgeting biases cities toward levying these charges up-front – which, given their importance in revenue, represents a cost to new home-buyers for the benefit of future service users, many of whom will not be the same people.

How Much are Today's Taxpayers Paying Compared to Services They Receive from Cities?

A pattern of surpluses that is evident since cities began reporting on an accrual basis in 2009 suggests that they have, on average, collected more revenues

8 See Schedule 61 of the Ontario Financial Information Return.

Table 2: Total Spending, Budget Versus Annual Report, (Ranked by Spending in 2015 Annual Report)

Municipality	Spending in Budget ($ billions)	Spending in Annual Report ($ billions)	Difference (percent)	Municipality	Spending in Budget ($ billions)	Spending in Annual Report ($ billions)	Difference (percent)
Toronto	11.9	10.8	10	Halifax	1.0	0.9	9
Montreal	6.4	6.2	3	Waterloo	1.6	0.9	72
Calgary	6.2	3.6	73	Niagara	1.0	0.8	20
Ottawa	3.8	3.3	15	Mississauga	0.9	0.8	15
Edmonton	3.4	2.8	24	Halton	1.2	0.7	64
Peel	2.5	2.0	23	Saskatoon	0.8	0.7	11
York	2.7	1.8	53	Windsor	0.9	0.7	18
Hamilton	2.0	1.6	23	Surrey	1.0	0.7	49
Winnipeg	1.6	1.5	5	Brampton	0.7	0.7	4
Quebec City	1.9	1.4	41	Sudbury	0.6	0.5	21
Vancouver	1.5	1.4	12	Vaughan	0.4	0.4	-17
Durham	1.3	1.1	20	Markham	0.4	0.3	42
London	0.9	1.0	-8				

Note: Spending amounts are rounded in table.
Source: Authors' calculations from 2015 municipal financial documents.

than the value of their operating and capital services would have justified. From 2008 through 2015, Canada's 25 largest municipal governments ran an aggregate cumulative surplus of $50 billion (Table 3). The 2015 total surplus, $8.6 billion, was 15 percent of their revenues that year. The municipalities with the largest surpluses as a share of revenues in 2015 – Vaughan, Halton Region, York Region, Markham, Calgary, Edmonton, Saskatoon, Mississauga, and Surrey – had surpluses of more than 20 percent of total revenues.[9]

The totals of operating balances and net worth of different levels of government support these findings. According to Statistics Canada's Government Financial Statistics, Canada's federal and provincial governments are running annual deficits, and have substantial negative net worth. By contrast, Canadian local governments are

9 This does not mean that cities, in reality, have hugely positive net worth. Obligations related to pensions are under-reported throughout Canada's public sector. But these challenges require Canada's cities to use accrual accounting more properly, not to continue budgeting on a cash basis.

running surpluses, and have accumulated positive net worth of over $260 billion.[10] We do not object to municipalities having positive net worth – it is an example we wish the senior governments would follow. It does, however, sit awkwardly beside municipal claims of infrastructure deficits, and constant pressure for more transfers from other levels of government.

Better Budgets Would Mean Better Infrastructure

These results suggest, moreover, that cities are not financing their infrastructure in a way that matches costs and benefits over time. Reserves are funds provided by past taxpayers, and upfront charges come from current taxpayers, yet it is future taxpayers who will benefit from capital projects. Many long-lived assets would be more appropriately financed by debt – or, especially in the case of assets that will generate revenue, such as toll roads and bridges, or water facilities – by equity from long-term institutional investors.

The appropriate share of financing infrastructure from up-front revenues as opposed to longer-term debt differs by type of government (see Dahlby and Smart 2015). An accounting practice that shows the long-term distribution of infrastructure benefits will aid officials in making long-term decisions for their cities. Better accounting is a means to the end of better government decision-making.

Recommendations for Better Municipal Financial Reports

In seeking to improve municipal fiscal accountability in Canada, we refer again to our smart and motivated, but non-expert, user. This person, a municipal councillor or taxpayer, should be able to pick up her city's budget and the financial report for a given year, start at page one, find the key aggregate revenue and spending figures early and easily, and compare them to see how close the results are to the plan. The majority of Canada's senior governments now publish budgets and financial reports that make this exercise possible (Busby and Robson 2016), and other public sector entities are following suit. School boards in Ontario, for example, have recently moved to full accrual budgeting. As in our previous surveys of municipal fiscal accountability (Dachis and Robson 2011, 2014, 2015), we have several suggestions to bring Canada's municipalities up to the same mark.

Adopt Accrual Accounting in Budgets

A key step would be to use accrual accounting in municipal budgets. Ideally, provinces that directly or indirectly mandate cash accounting would change their rules to permit accrual accounting instead of, or alongside, cash. Even absent provincial action, municipalities could on their own present budget numbers consistent with their financial statements.

Now that municipalities have been presenting accrual-based financial reports for the better part of a decade, presenting accrual-based budgets as well should not be any major challenge, either in compiling them or explaining them. Accrual-based budgeting would also make the multi-year capital budgets produced by all large cities more helpful, by showing the amortization of capital. Accrual accounting would inform municipal councillors and taxpayers – whether they are looking at the financing of long-lived infrastructure assets, for example, or wondering how future obligations such as the pension entitlements of municipal employees, or landfill decommissioning and other environmental liabilities, affect their municipality's net worth.

10 See Cansim Table 385-0032.

Table 3: Surplus of Canadian Municipalities Ranked by Total Spending in Annual Report, 2015

Municipality	2015 Surplus: As Share of 2015 Revenues *(percent)*	2015 Surplus: Total *($ millions)*	2008-15 Surplus Cumulative *($ millions)*	Municipality	2015 Surplus: As share of 2015 Revenues *(percent)*	2015 Surplus: Total *($ millions)*	2008-15 Surplus Cumulative *($ millions)*
Toronto	9.9	1,194	6,476	Halifax	5.1	50	625
Montreal	9.4	642	3,878	Waterloo	19.9	227	683
Calgary	24.1	1,139	7,638	Niagara	9.4	88	468
Ottawa	11.5	427	3,025	Mississauga	22.1	220	695
Edmonton	22.3	798	4,691	Halton	34.8	393	1,910
Peel	17.6	435	2,424	Saskatoon	22.3	211	1,642
York	28.8	714	3,206	Windsor	2.6	20	459
Hamilton	7.7	136	1,307	Surrey	21.4	183	1,455
Winnipeg	15.3	269	1,670	Brampton	14.1	107	1,085
Quebec City	18.5	313	1,267	Sudbury	4.0	21	252
Vancouver	13.9	220	1,208	Vaughan	41.3	300	1,256
Durham	15.5	202	1,391	Markham	26.5	108	958
London	12.5	145	1,175				
All Major Cities					**15.5**	**8,562**	**50,843**

Note: For Quebec City, we use spending and revenue totals from non-consolidated results for 2008.
Source: Authors' calculations from municipal financial documents.

As in the private sector, public sector accounting standards evolve as opinions about the best ways to represent economic reality evolve. Current public sector standards are open to criticism, for example, for valuing pension obligations using arbitrary, rather than market-based, discount rates, which typically make those obligations look smaller than the cost to pay them off at the valuation date (Laurin and Robson 2016). For municipalities to move, in both their budgets and their financial reports, to the standards currently followed by the federal government and most provinces and territories would nevertheless be a big step forward.

In some provinces, accrual accounting in budgets would create tension with the requirement that municipalities present balanced operating budgets. However, since accrual accounting consolidates all items affecting net worth into common revenue and expense totals, it makes the concept of a separate operating budget irrelevant. One option would be to focus on the overall bottom line that, under accrual accounting, should represent change in net worth. This approach parallels that of the federal and most provincial governments, which target their budget balances on an accrual basis. Other measures related to fiscal prudence and sustainability, such as interest costs relative to revenues, are possible. Indeed, this debate about the appropriate public sector fiscal anchor, whether it is balanced budgets or a debt-to-GDP ratio, applies as well to federal and provincial budgets. The key point is that provincial legislation should not mandate budget targets that are inconsistent with the accrual accounting cities already use in their financial reports.

Present the Headline Figures Early and Prominently in Budgets and Financial Reports

A time-constrained, non-expert should not have to dig through dozens or even hundreds of pages in a document or a slide deck to find a city's total budgeted or actual spending. Similarly, this person should not come across more than one candidate for each total during her search, and wonder which is the correct number. Some senior governments put their definite consolidated figures close to the front of their budgets and financial reports: there is no reason why municipalities cannot do the same. Simpler, more prominent display of the key numbers would also help cities explain their content and importance to councillors, the media, taxpayers and citizens.

Show Gross, Consolidated, City-wide Spending

Municipal budgets should also show gross spending and revenue, so users of financial statements have one comprehensive overview of a government's fiscal footprint. Presenting numerous versions of the overall fiscal footprint of a city – such as the amount that property taxes cover, or excluding fully rate-supported divisions of the city – muddles the understanding of how much taxpayers in the city – who, as a whole, pay both property taxes and user fees – pay for their city services.[11]

Show Deviations from Budget Plans

Accounting differences aside, cities should prominently display tables reconciling year-end results with budget promises. Another valuable practice, followed by the federal and many provincial governments, is in-year reports showing results relative to plan. Many municipalities do produce regular reports that show the difference between budgeted and actual spending, but the inconsistent accounting in budgets and financial reports reduces their value.

Present Budgets and Financial Reports in a Timely Manner

Another important feature of accountability is ensuring that cities have formally approved spending before that spending happens. Many municipal governments are slow in providing their final approval for government spending and a retrospective look at last year's figures. Those cities that delay budget and financial report approval many months into their fiscal years should approve them sooner.

11 As for what entities to include, senior governments typically distinguish between Crown corporations whose principal revenue source is the government and do not operate in a commercial environment and Crown corporations whose principal revenue sources are sales to outside parties and do operate in a commercial environment. These governments consolidate the former in their financial statements, while recording only transactions with, and equity investments in, the latter. Applying this distinction at the municipal level suggests consolidating water and waste utilities, while showing transactions and equity investment in connection with many other government business enterprises, such as electricity utilities that are often standalone corporations. This recommendation does not pre-empt presentations of other information, including figures net of rate-supported services, to show the effect of spending on property-tax rates.

Conclusion – The Need to Improve Municipal Fiscal Accountability

It is high time that Canada's municipalities adopted budgeting practices that are becoming standard at senior levels of government. Whether mandated by their provinces or not, cities should present accrual-based budgets consistent with their financial statements, thereby avoiding the baffling discrepancies and potentially biased decisions about revenue and spending that inconsistent cash budgeting creates. The confusion created by different accounting in municipal budgets and financial reports might not be intentional, but it is real and its effect on transparency and accountability is deleterious. Proposals to give cities more taxing power are common, and pressure for more transfers to cities from senior governments is constant. Cleaner financial presentations from municipalities should precede both. Clearer, more consistent figures and better accountability for hitting or missing budget targets would bring the financial management of Canada's municipalities better into line with their fiscal impact and their importance in Canadians' lives.

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