

DATE OF MEETING | MARCH 15, 2023 |

AUTHORED BY | DAN BAILEY, MANAGER, ACCOUNTING SERVICES |

**SUBJECT                      2022 SURPLUS ALLOCATION**

## **OVERVIEW**

### **Purpose of Report**

To provide the Finance and Audit Committee with information pertaining to the allocation of the 2022 operating surplus. |

### **Recommendation**

That the Finance and Audit Committee recommend that Council approve the allocation of the 2022 operating surplus as follows:

1.	<b>General Fund</b>	
	a. RCMP Contract Reserve	\$ 3,000,000
	b. Snow and Ice Control Reserve	130,000
	c. Special Initiatives Reserve	2,300,000
	d. Property Acquisition Reserve	2,100,000
	e. General Capital Reserve	<u>1,014,855</u>
		<u>\$ 8,544,855</u>
2.	<b>Sewer Fund</b>	
	a. Sewer Reserve	<u>\$ 224,302</u>
3.	<b>Water Fund</b>	
	a. Water Reserve	<u>\$ 198,344</u>

## **BACKGROUND**

The compilation of the 2022 draft financial statements is in progress and the audit by KPMG LLP started on 2023-MAR-06. In preparing the financial statements, staff need to allocate the surplus prior to finalization of the audit.

In order to help stabilize future funding sources and minimize the impact on tax rates, a Reserve Policy was established in 2019. This policy provides guidance with respect to the development, maintenance and use of City Reserve Funds. The policy also institutes minimum and maximum values, where appropriate, to ensure levels of reserves are on hand at any given time. As outlined in the Policy, the first use of surplus funds is to bring the reserves up to the identified minimum balance.

The primary objectives of the reserve policy is to support financial resiliency by:

- Providing funds for operating emergencies
- Ensuring sustainable funding for infrastructure
- Ensuring stable and predictable property tax levies

## **DISCUSSION**

The City of Nanaimo accounts for its budget within three operating funds: general, sewer and water. The total combined net operating surplus for the year is \$8,967,501 (unaudited). A summary of surplus results by department is documented at a more detailed level in **Attachment A**. This report lists the 2022 total surplus (deficit) by function within each City department, and includes analysis for variances that exceed \$100,000.

The unaudited financial results for each operating fund at 2022-DEC-31 and the recommended surplus allocation for each fund are as follows:

### **1. General Fund**

The general fund surplus was \$8,544,855 at 2022-DEC-31. This represents 4.99% of the budget. This surplus is largely due to the following:

Source	Reason	Amount
<b>RCMP Contract</b>	Costs were lower than expected due to member vacancies	\$ 2,974,000
<b>Wages &amp; Benefits</b>	Savings due to numerous position vacancies throughout the City	\$ 2,948,000
<b>Investment Income</b>	Multiple unprecedented interest rate increases	\$ 2,366,000
<b>Building Permit Revenue</b>	Higher revenue than planned	\$ 598,000
<b>Nanaimo Prosperity Corporation</b>	Unspent budget due to delayed start	\$ 407,000
<b>Contaminated Sites Liability</b>	Liability associated with the land acquired through tax sale on Machleary Street	(\$1,533,000)

Staff propose that the 2022 operating fund surplus be allocated to reserves as follows:

**RCMP Contract Reserve** **\$ 3,000,000**

The RCMP Contract Reserve is used to fund RCMP contract costs that exceed the budget estimate. The reserve balance has fallen below its minimum balance threshold of \$1,611,855, and is required to be topped up. As well, the RCMP labour contract expires on 2023-MAR-31 and retro active payments will be required when the contract is settled. Based on the most recent settlement, additional funds will likely be needed when an agreement is reached. Setting aside the RCMP Contract surplus budget amounts each year will provide a funding source if additional funds are needed. The balance in this reserve was \$1,533,433 at 2022-DEC-31.

### **Snow and Ice Control Reserve**

**\$ 130,000**

The Snow and Ice Control reserve is used as a source of funding when the actual annual costs for snow and ice control exceed the budgeted amount. The reserve balance has fallen below its minimum balance threshold of \$1,330,000, and is required to be topped up. The balance in this reserve was \$1,200,000 at 2022-DEC-31.

### **Special Initiatives Reserve**

**\$2,300,000**

The Special Initiatives reserve is used to fund specific City initiatives in the following year. The \$2,300,000 reserve allocation is required to fund the new Asset Retirement Obligations (ARO) accounting standard that must be implemented in 2023. This new Public Sector Accounting Board (PSAB) standard mandates that the City record any legal obligations associated with retiring tangible capital assets. The balance in this reserve was \$5,822,689 at 2022-DEC-31.

### **Property Acquisition Reserve**

**\$ 2,100,000**

The Property Acquisition reserve has allowed Council in the past to make strategic land purchases including the Commercial Street properties and the 1861 East Wellington road property. This reserve allocation will allow flexibility for any future land purchase that Council wishes to make. The balance in this reserve was \$3,261,483 at 2022-DEC-31.

### **General Capital Reserve**

**\$ 1,014,855**

The General Capital reserve is used to fund general (non-sewer and water) projects. \$273,000 of this reserve was used to fund the RCMP detachment business case in 2022. This \$1,014,855 reserve allocation will allow for future funding of general fund projects. The balance in this reserve was \$3,862,247 at 2022-DEC-31.

## **2. Sewer Fund**

The sewer fund surplus was \$224,302 at 2022-DEC-31. This represents 3.34% of the budget. The majority of the surplus results from higher than anticipated user fee revenues as well as wage and benefit savings due to position vacancies.

### **Sewer Reserve**

**\$224,302**

Staff propose that the \$224,302 sewer fund operating surplus be allocated to the sewer reserve to be used to fund future sewer projects. The balance in this reserve was \$14,392,366 at 2022-DEC-31.

### 3. *Water Fund*

The water fund surplus was \$198,344 at 2022-DEC-31. This represents 1.60% of the budget. The majority of the surplus results from wage and benefit savings due to position vacancies.

#### **Water Reserve**

**\$198,344**

Staff propose that the \$198,344 water fund operating surplus be allocated to the water reserve to be used to fund future water projects. The balance in this reserve was \$28,861,337 at 2022-DEC-31.

#### **Summary**

If a municipality has a small surplus it means that tax rates were appropriately set to meet current year operations. However, it does not provide any excess monies to be transferred to reserves for the funding of future projects or cover any unexpected operating costs that may occur.

If low surplus values are sustained year after year, tax rates can potentially become more volatile as a larger percentage of funding for unexpected events and/or projects will need to come from current year taxes rather than reserves.

By transferring excess surplus funds to reserves in 2022 it means that the need for future year tax increases are mitigated as these monies can be used to cover any unexpected operating costs, drops in revenue sources or fund future projects.

#### **OPTIONS**

1. That the Finance and Audit Committee recommend that Council approve the allocation of the 2022 operating surplus as follows:

1. **General Fund**

a. RCMP Contract Reserve	\$ 3,000,000
b. Snow and Ice Control Reserve	130,000
c. Special Initiatives Reserve	2,300,000
d. Property Acquisition Reserve	2,100,000
e. General Capital Reserve	<u>1,014,855</u>

**\$ 8,544,855**

2. **Sewer Fund**

a. Sewer Reserve	<u><b>\$ 224,302</b></u>
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3. **Water Fund**

a. Water Reserve	<u><b>\$ 198,344</b></u>
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- The advantages of this option: Transferring excess surplus funds to reserves this year means that the need for future year tax increases are mitigated as these monies can be used to cover any unexpected operating costs, drops in revenue sources or fund future projects.
- Financial Implications: \$8,967,501 is reserved to fund general, sewer and water projects and operations in the future.

2. That Council direct specific surplus funds to other priorities.

### **SUMMARY POINTS**

- The general fund recorded an operating surplus of \$8,544,855, or 4.99% of approved budget in 2022. Staff propose that the 2022 surplus be allocated to the:
  - RCMP Contract Reserve - \$3,000,000
  - Snow and Ice Control Reserve - \$130,000
  - Special Initiatives Reserve - \$2,300,000
  - Property Acquisition Reserve - \$2,100,000
  - General Capital Reserve - \$1,014,855
- The Sewer Fund recorded an operating surplus of \$224,302 or 3.34% of approved budget in 2022. Staff propose that this surplus be allocated to the Sewer Reserve.
- The Water Fund recorded an operating surplus of \$198,344 or 1.60% of approved budget in 2022. Staff propose that this surplus be allocated to the Water Reserve.

### **ATTACHMENTS:**

Attachment A: Summary of 2022 Surplus

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