Accounting 101 for Councillors, Mayors and Free Press Columnists

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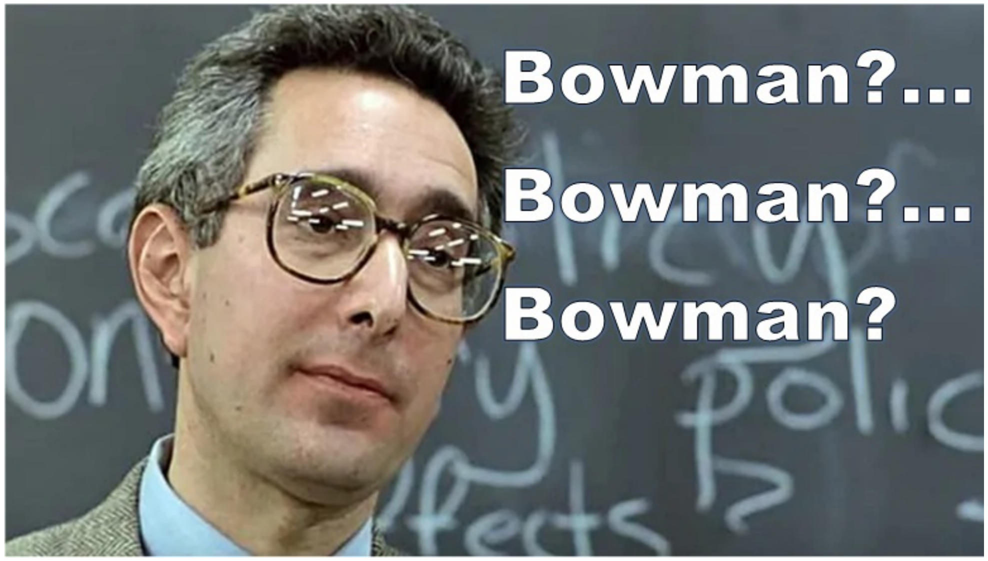
FEBRUARY 24, 2020 (HTTPS://WWW.DEARWINNIPEG.COM/2020/02/24/ACCOUNTING-101-FOR-COUNCILLORS-MAYORS-AND-FREE-PRESS-COLUMNISTS/)



In 2020, the Winnipeg City Council, in an effort to alleviate the effects of the... Anyone? Anyone? ...terrible choices of the past, passed the... Anyone? Anyone?

Dear Winnipeg,

This weekend, I read an interesting piece by Tom Brodbeck in the ol' Freep (https://www.winnipegfreepress.com/local/two-sets-of-books-too-much-confusion-568088782.html) talking about how the City uses two different sets of accounting standards for its budget and its year-end financial statements.

[*Yup, it's going to be that kind of letter. Better pour yourself a glass of wine. I'll wait.*]

He describes how most cities in Canada, Winnipeg included, use Public Sector Accounting Principles (PSAS) when preparing their year-end financial statements (like they should), but not when preparing their budgets.

[*Woah, those are some mighty huge sips there! Pace yourself, my friend!*]

The article quotes a report from the C.D. Howe Institute:

> "In these municipalities, the revelation of substantial surpluses in the year-end financial statements is completely at variance with peoples' understanding, and the anxiety of the budget debate," the report says. "Most Canadians would be amazed to learn that Canada's cities routinely record large surpluses, and — in contrast to many senior governments — have positive net worth."

Then Tom goes on to share that "the city posted a $295-million surplus in 2018, according to its consolidated financial statements."

With no additional context.

I suppose we can only assume that Tom's previous pieces, such as "Dispel the myth: city cupboards are not bare (WFP Dec 30, 2019) (https://www.winnipegfreepress.com/local/dispel-the-myth-city-cupboards-are-not-bare-566578601.html)" are supposed to provide that context.

But with that, Tom proves his own point: "It's a hot mess, and unnecessarily confusing for the public." [*And for newspaper columnists as well, apparently.*]

Given that I've also had a Councillor tell me to my face at an EPC meeting that there is no relation between the Operating Budget and the Capital Budget, I think it's time for a little accounting lesson regarding the least understood portion of financial reports: the Balance Sheet.

[*Slurp, slurp, gulp.*]

Not to mention, Tom's position does lead to an interesting question: how can we be broke if we're posting nearly $300-million-a-year surpluses?

So here goes. [*Gulp, gulp.*]

Financial statements have a few major parts to them. One of them is the Income Statement (or the Profit & Loss Statement, or P&L, or in the municipal world, the Statement of Operations). I'll just call it the P&L going forward. If you're following along at home, it's on page 59 of the 2018 Annual Financial Report (https://www.winnipeg.ca/finance/files/2018AnnualReport.pdf), and it shows, as Tom told us, a $295 million surplus for 2018.

It's probably one of the easier documents to understand, as it's basically a list of all the income for the year, minus all the expenses. If you spent less than you earned, then you have made a surplus for the year. If you spent more than you earned, then that means a loss. Easy-peasy.

The Balance Sheet, on the other hand, is more like an up-to-date list of all the stuff you own at the end of the year.

There are three main categories of stuff on the Balance Sheet, or Consolidated Statement of Financial Position as per PSAS (PSAS arranges the items on the page differently, but the relationships are easier to understand when we lay them out in the same way as for a business):

- **Assets:** this is money, and stuff that is worth money.

In the case of a person, this is cash (whether in the bank or the sofa), your house, your car, your RRSP, and your collection of Beanie Babies.

In the case of a city, this means cash (whether in the bank or in the Mayor's petty cash envelope in the top left drawer of his desk). [*I do not know for sure if that is where he keeps it.*]. It also includes all our infrastructure, like bridges, roads, pools, fire trucks and everything else like it.

- **Liabilities:** this is debt, and other money that is owed to others.

In the case of a person, this would be your mortgage, your credit card balance, and lines of credit, and that $5,000 you still owe your buddy for the Beanie Babies collection you bought off of him in 1999.

For cities, this is municipal bonds, lines of credit, and money owed to suppliers and contractors that haven't been paid yet.

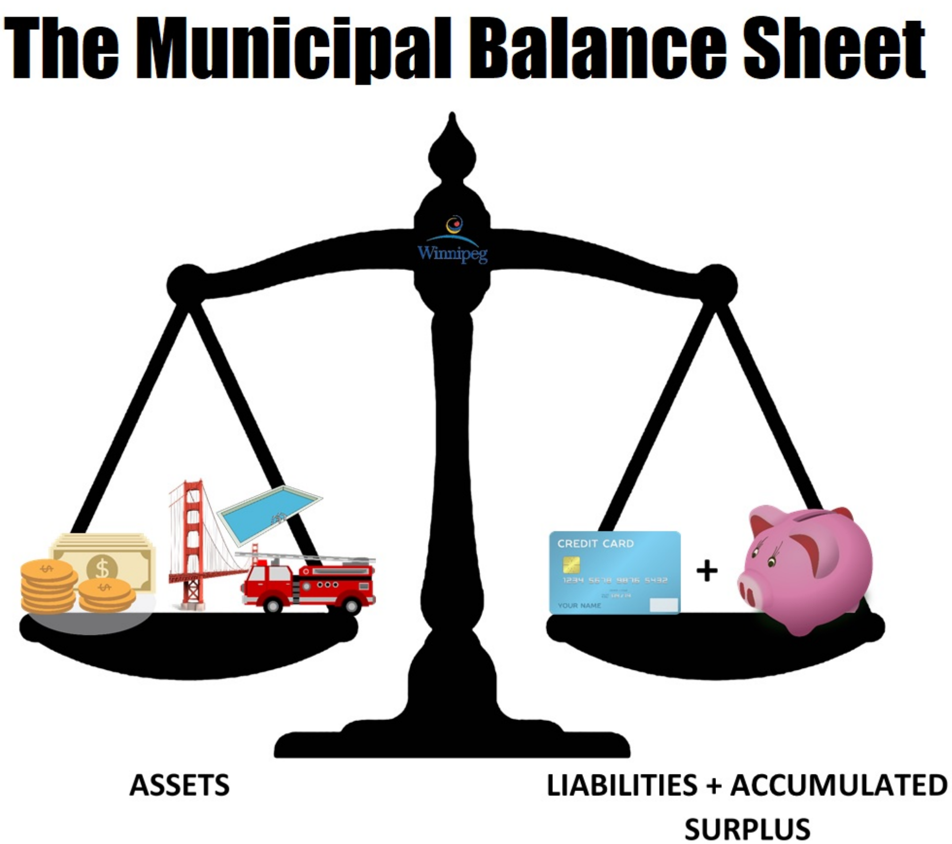
- **Accumulated Surplus:** this is also called Retained Earnings in the for-profit, corporate world.

In the case of a person, this would be your Net Worth. If it's negative, that's bad. If it's positive that's good. If it's over a million dollars, then congratulations, you are a millionaire. [*Also, can I borrow your monocle?*]

For a city, this is simply the running total of all the surpluses and/or losses generated every year on the P&L since its incorporation.*

***That part is important, so I'll say it again:** the surplus generated on the P&L statement at the end of every year gets added to the Accumulated Surplus on the Balance Sheet. That's the main relationship between the P&L and the Balance Sheet: the money left over from the first goes into the second. Every year.

Here's the second important point: it's called a Balance Sheet for a reason.



The stuff on the left is always equal to the stuff on the right. It's "balanced".

So here's the sneaky part. You can move money around the Balance Sheet and it doesn't show up on the P&L statement.

Wanna buy a new fire truck 'cause your old one got stolen (https://winnipeg.ctvnews.ca/suspect-in-custody-after-stealing-fire-truck-attempting-to-run-people-over-police-1.4708723)? That's not an expense, so we don't mark it on the P&L as an expense. It's actually a capital purchase, so we just need to move some dollars on the Balance Sheet, from Cash to Infrastructure. $1 of Cash simply becomes $1 of Infrastructure.

[*Sorry, those are the rules of accounting. Generally, if you buy something that will last more than a year, then it's a capital purchase that goes on the Balance Sheet, otherwise it's an expense that goes on the P&L. Fire trucks and roads and swimming pools? Capital purchase. Pencils and wages and gasoline? Expense.*]

As long as the Balance Sheet stays balanced, that is. Which it does in this case, because we just moved money around on the one side of the scale. Still balanced.

And we can continue funding our infrastructure construction (and let's not forget replacement (https://www.dearwinnipeg.com/2019/10/24/if-it-looks-like-a-debt-and-it-quacks-like-a-debt-then-it-must-be-a-zombie/)) like this, moving money from Cash to Infrastructure, forever. Or, at least until we run out of Cash.

So then what?

Easy! We just need to get more cash, right?

Well, not so fast. The only way to add anything to one side of the scale is to add an equal amount to the other side.

So if we want to add cash to one side, we will need to add an equal amount of either debt or surplus (or a mix of both!) to the other side.

And that makes sense when you think about it, doesn't it? If you want to have a new $10 that you didn't have before, you either need to borrow $10 (debt), or you need to earn $10 then not spend it (surplus).

In other words, the money we need for infrastructure will always have to come from either debt, or surpluses, or both. Because the Balance Sheet said so!

And since we want to use as little debt as possible (being a responsible city), and since surpluses come from the P&L, where we spent less than we made, we actually NEED the City to "turn a profit".

Otherwise, there's no money for infrastructure.

So is $295 million enough? Tom seems to think so.

But we've already done the math (https://www.dearwinnipeg.com/2019/03/21/the-not-so-golden-ratio/), and it says our $35 Billion of infrastructure requires about $1.4 Billion a year simply for replacement of our crumbling roads, bridges, pools, community centres, etc. And let's not forget that 88% of that is just for the roads and pipes (https://www.winnipeg.ca/infrastructure/pdfs/Infrastructure-Plan-2020.pdf), our most basic infrastructure.

We NEED the City to be posting Billion-dollar-plus surpluses (less depreciation, which was $257 million in 2018, but that's a topic for another time). Instead we're only scratching out a bit less than $300 million.

And you want to build even more new stuff (https://www.dearwinnipeg.com/2019/05/31/a-tale-of-two-bridges/)? [*Get out of here, you're obviously drunk…*]

So while $295 million may seem like an obscene amount of money to us mere mortals [*except for you, monocled folks!*], it's not even close to enough to keep up with the infrastructure we've already built. We need somewhere around an extra $1 Billion. Every year.

We could get it by cutting services, although we'd have to cut ALL of them to zero (https://www.dearwinnipeg.com/2019/03/01/budget-day-special-is-finance-minister-fielding-right/) to get to that much money. Or we could triple our property taxes. Either of those would increase our annual surpluses by the amount needed. But neither seems like a very realistic, attainable solution.

Looks like it's time to dispel the myth: the city cupboards ARE bare!

Clearly, we need to start doing things differently as a city, and that starts with acknowledging the problem: we have more infrastructure than we can currently pay for, so we need to stop building new stuff right now. Then, instead of arbitrary blanket budget cuts across the board, we get to work nurturing our most profitable investments (https://www.dearwinnipeg.com/2019/11/17/the-million-pothole-challenge/), in order to keep increasing our revenue per sq ft of land (https://www.dearwinnipeg.com/2020/01/14/its-all-downhill-from-here/).

It'll take time, but it's the only way to get out of this mess.

Sloppy smooches,

Elmwood Guy

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