9.0 NET ASSET BALANCE (NAB)

In a competitive marketplace where customers have buying choices, the prices charged for goods or services are essentially self-regulating. Businesses must strive for cost efficiency in order to be profitable while charging an equal or lower price than their competition. Industries which enjoy a monopoly and are not subject to competition, such as electrical utilities, tend to be regulated by governmental authority to protect the public from unreasonable or unfair pricing. In such cases, the regulator allows the utility a revenue recovery sufficient to recoup its costs and receive a fair rate return on its invested capital.

IWMC, as a crown agency, has no invested capital from shareholders, but does have the ability to accumulate earnings. IWMC made application for revised rates, and in its February 24, 2022 Order responding to the application, IRAC granted a 1% NAB for IWMC under the Act, allowing an opportunity to accumulate earnings to assist with operations.

It is difficult to find a scenario identical to IWMC's, where a crown or government agency manages solid waste on a regulated basis. The services provided by IWMC, on behalf of the provincial government, are like those in many other jurisdictions, usually administered at the municipal level, but not subject to independent regulation. Such operations tend to be carried out within a government department and with little or no oversight by a regulating agency, and therefore with less opportunity for scrutiny by the public.

In considering appropriate reserve funds for IWMC, the aspect of a return on invested capital to reward shareholders is not applicable. There are no shareholders who have risked their own resources and who therefore expect a return. There are ratepayers, who are essentially taxpayers. The government does not require or expect a return on any original investment, and accordingly, it would be inappropriate for its conduit, IWMC, to expect one. The purpose of appropriate reserve funds would be to allow IWMC sufficient working capital to address the uncertainties and irregularities of business and be well positioned to address other items, such as the retirement/replacement of assets and retirement of debt.

The nature of the business makes it impossible to operate in a perfect scenario, where revenues permitted under regulation exactly match actual costs incurred, in both timing and amount. Therefore, financing is required to help manage timing differences and unexpected amounts. As well, significant costs for capital items which have economic lives greater than one year must be financed (long-term debt) and amortized over numerous periods. In many cases, the amortization period (number of years) varies from the financing period so that the cash required each year to repay the debt does not match the amortization amount allowed to support the regulated rate for that year. This puts pressure on available resources.

In business the occurrence of unexpected events can significantly and negatively affect operations. The recent pandemic and weather-related events caused disruptions and economic stress to many businesses, in some cases with catastrophic outcomes. IWMC's 2023 results demonstrate this kind of stress, with the post-pandemic period driving high inflation and interest rates, contributing to higher Operating Loan interest and expensive facility and equipment repair costs (also impacted by aging assets). This is anticipated to continue through the 2024/25 fiscal year and beyond, and also includes increasing wage rates brought about by significant inflationary pressures.

Financial Position

A summary of the corporation's assets, liabilities and net assets balances are captured in Table 1 for 2019 to 2023. The shaded area presents the net assets separated into those that are invested in capital assets from those that are unrestricted. At the bottom of the schedule is more detailed information to show the calculations to arrive at these two component totals for each of the years.

Showing the investment in capital assets separately from unrestricted net assets provides a clearer picture of where the corporation's resources have been employed and assists with an understanding of financing and timing issues. The shaded area shows that in 2019 the amount invested in capital assets exceeded capital debt items by only $62,000. In the ensuing years, the overall level of capital assets was approximately maintained while capital debt was paid down, so that by March 31, 2023, the net amount invested in capital assets had risen to $341,000.

In the four years following 2019 the corporation had incurred overall losses (excess of expenditures over revenues) of $604,000 (see Table 3). Because it had increased its net investment in capital items by $279,000 to $341,000, this meant that the unrestricted net asset balance had taken a hit of $883,000, calculated as $604,000 plus $279,000. This was a drop of 66%. It is worth noting that this period included a worldwide pandemic and escalating inflation, and all the problems and challenges that came with those two occurrences. The requirement to have rate increases approved annually means that IWMC is not well-positioned to respond quickly to such threats and would therefore benefit from having a modest NAB.

Table 2 presents a cash flow schedule for the years 2019 to 2023 to show the sources of cash generation and the uses of cash (refer to the shaded column). Revenues exceeded expenditures, after adding back expenses that do not require cash (amortization, etc.) generating slightly more than $11.3 million. Changes in working capital items other than cash (accounts receivable and payable) reduced this amount by $200,000. Purchases of capital assets used $5.6 million, and payments of principal on long-term debt, net of new borrowings were $9.3 million. Government assistance for capital items provided $2.5 million, and the cashing in of term deposits along with short term borrowings provided $4 million. While the table shows that for the five-year period the corporation's cash position improved by $2,707,000, without the term deposit and short-term borrowings of $4 million which were not generated from operations, the corporation's cash actually declined by $1.3 million.

The corporation manages an asset base of approximately $29 million and administers annual costs of more than $23 million. To manage the business and provide services efficiently for ratepayers, we need to be properly financed. For the most part, it appears that capital debt has been used to finance long-term assets. However, the repairs required to aging infrastructure after 20 years, combined with continuing pressures from economic uncertainties and a rapidly increasing population base support the position that IWMC and its ratepayers would continue to benefit from the ability to accumulate a modest net asset balance. The NAB of $1.670 million as of March 31, 2023, represents only 5.7% of our asset base.

Net Asset Balance

Financial experts recommend businesses maintain three, six, even 12 months of operating expenses in reserve to manage unexpected costs or reductions in revenue (https://corporatefinanceinstitute.com/resources/knowledge/finance/cash-reserves/; https://quickbooks.intuit.com/ca/resources/cash-flow/why-you-need-a-business-cash-reserve/; Developing your Reserve Fund Policy A Template and Guide for Nonprofits, FMA Institute, https://fmaonline.net/npqreserves/). Monthly operational costs for IWMC in 2023 are approximately $2M. As a Crown Corporation, we recognize that IWMC is not exactly like other private sector businesses or non-profits, but we do operate as a business, and we require flexibility to run the operation effectively and efficiently. While approximately 78% of our revenue stems from residential user fees and is reasonably predictable, the remaining 22% is generated primarily from the commercial sector and is subject to greater uncertainty. While IWMC does have the ability to secure financing from the province if necessary, the logistics and timelines associated with Treasury Board submission and approval hinder the ability of the corporation to navigate unexpected expenses, such as equipment failure.

In recognition of our unique situation and in fairness to ratepayers we continue to advocate that a conservative NAB at the low end of what is generally recommended is warranted. IWMC's particular circumstances mean there is no precise calculation to determine an appropriate NAB. A logical and fair approach is to establish a reasonable amount, and then to monitor and adjust it as time progresses and circumstances support.

In Order WM22-01 IRAC approved the creation of a NAB for IWMC. IWMC had proposed a NAB of $5.5 million, which would represent approximately 20% of the asset base, and a debt-to-equity ratio of 4.5 to 1. From the 2023 position, this additional $3.83 million could occur ideally over several years, and the $5.5 million target would be the total amount invested, both in capital assets (restricted) and unrestricted net assets in accordance with Board policy not yet developed.

These unrestricted assets would be intended reduce the need for an external line of credit and be sufficient to maintain operations for approximately three (3) months, if necessary. The NAB would also provide some flexibility to manage cash flow and facilitate unexpected one-time expenses effectively, and fund smaller, emergency capital expenditures under a threshold defined in policy.

An external line of credit is not a reasonable or cost-effective way to fund the timing differences regarding the economic life of certain capital assets, such as carts, which must be amortized versus the length of time over which they could be financed particularly when carts are an annual purchase both to supply new residences and replace aging carts that have failed. As well, in a period of rising interest costs it should prove to be less expensive in the long run to “self-finance” certain items such as low dollar capital assets like vehicles and carts, than to borrow commercially, and it should also help level out cash flow pressures arising from timing of payments and receipts.

In the past year IWMC’s already thin human resources were stretched further by unforeseen staff exits. The effort and time to properly manage a very comprehensive RFP process for the collection of residential waste carts was considerable and consuming. The corporation intends in the coming year to focus its attention on the development of proper policies regarding the effective use of resources between capital and operations, which includes a more robust net asset balance policy. In the meantime, it feels that the continued provision for a targeted increase in its net asset balance funded through a 1% addition to rates is reasonable and warranted.

IWMC Financial Position Past 5 Years **Table 1**
From Published Financial Statements and
Modified Net Asset Presentation
(all amounts in 000s)

	2023	2022	2021	2020	2019
ASSETS					
Current assets	6,995	6,701	3,658	4,725	4,813
Term deposits - non current	-	-	-	-	-
Performance deposits	620	620	617	615	615
Capital assets	21,744	19,430	20,476	21,673	22,851
	29,359	26,751	24,751	27,013	28,279
LIABILITIES					
Payables and accruals	2,961	2,959	2,759	3,112	2,601
Contractor deposits	614	614	614	614	614
LTD in total	10,092	11,882	13,881	15,535	17,522
Dfd Gov assistance	2,628	2,535	2,329	2,470	2,615
Asset retirement obligation	8,683	4,230	3,580	3,277	2,652
Contract Liability	1,211	1,203	-	-	-
Short-Term Borrowings	1,500	2,000	-	-	-
	27,689	25,423	23,163	25,008	26,004
NET ASSETS (modified presentation)					
Invested in capital assets (below)	341	783	686	391	62
Unrestricted net assets (below)	1,329	545	902	1,614	2,212
	1,670	1,328	1,588	2,005	2,275
LIABILITIES AND NET ASSETS	29,359	26,751	24,751	27,013	28,279

Invested in Capital Assets					
Net capital assets	21,744	19,430	20,476	21,673	22,851
Long-term debt	(10,092)	(11,882)	(13,881)	(15,535)	(17,522)
Dfdgov't assistance	(2,628)	(2,535)	(2,329)	(2,470)	(2,615)
Asset retirement obligation	(8,683)	(4,230)	(3,580)	(3,277)	(2,652)
	341	783	686	391	62
Unrestricted Net Assets					
Current assets	6,995	6,701	3,658	4,725	4,813
Term deposits - non current	-	-	-	-	-
Performance deposits	620	620	617	615	614
Payables and accruals	(2,961)	(2,959)	(2,759)	(3,112)	(2,601)
Contractor deposits	(614)	(614)	(614)	(614)	(614)
Contract Liabilities and short-term borrowings	(2,711)	(3,203)	-	-	-
	1,329	545	902	1,614	2,212

IWMC **TABLE 2**
Cash Flow for 5 years 2019 to 2023
(all amounts in 000's)

Cash Provided From (Used In)	Total 5 Years	2023	2022	2021	2020	2019
Earnings	(576)	342	(260)	(417)	(270)	29
Add: Amortization	11,436	2,981	2,413	2,066	2,056	1,921
Accretion expense	303	127	85	26	19	46
Losses on disposals	159	34	23	19	32	51
Cash from Earnings	11,322	3,484	2,261	1,694	1,837	2,047
Changes in working capital items						
AR	455	(314)	59	42	(115)	782
Prepaids	(157)	(129)	(20)	(3)	(28)	23
Payables	(497)	3	200	(353)	511	(858)
Cash from working capital items	(200)	(440)	239	(314)	368	(53)
Investing						
Purchases of capital assets	(5,698)	(1,006)	(859)	(808)	(451)	(2,574)
Proceeds sale of cap assets	92	3	35	53	-	1
Cash used to buy capital assets	(5,606)	(1,003)	(824)	(755)	(451)	(2,573)
Financing						
Short term borrowings	1,500	(500)	2,000			
Increase in LTD	1,395			252		1,143
Principal payments on LTD	(10,684)	(1,786)	(1,994)	(1,905)	(1,987)	(3,012)
Term deposits cashed and used	2,500	-	-			2,500
Gov assistance received	2,484	101	1,409	5		969
Other	(4)	(4)	(8)	(4)	1	11
Net cash used in financing	(2,810)	(2,190)	1,407	(1,652)	(1,986)	1,611
Increase (decrease) in cash	**2,707**	**(148)**	**3,082**	**(1,027)**	**(232)**	**1,032**
Beginning cash	1,109	3,964	882	1,909	2,141	1,109
Ending cash	**3,816**	**3,816**	**3,964**	**882**	**1,909**	**2,141**

Table 3

IWMC Summary of Net Revenues/Expenditures	2023	2022	2021	2020	
Opening net asset balance					
Capital	783	686	391	62	
Unrestricted	545	902	1,614	2,212	
	1,328	1,588	2,005	2,274	
Excess revenues/expenditures for the year					**Totals for**
Made up of:					**4 years**
Capital	-442	97	295	329	**279**
Unrestricted	784	-357	-712	-598	**-883**
Net for the year	**342**	**-260**	**-417**	**-269**	**-604**
Ending net asset balance					
Capital	341	783	686	391	
Unrestricted	1,329	545	902	1,614	
	1,670	1,328	1,588	2,005	