

Staff Report



To	City Council as Shareholders of Guelph Municipal Holding Inc.
Date	Wednesday, July 22, 2020
Subject	2019 Guelph Municipal Holdings Inc. Financial Statements

Recommendation

1. That the 2019 Consolidated Financial Statements for Guelph Municipal Holdings Inc. be received.
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Executive Summary

Purpose of Report

To present and review the 2019 Guelph Municipal Holdings Inc. (GMHI) Notice to Reader Financial Statements.

Key Findings

On January 1, 2019 GMHI sold its shares of Guelph Hydro Electric Systems Inc. (GHESI) to Alectra Inc. (Alectra) in return for 4.63% of Alectra's shares. On June 30, 2019, GMHI and GMHI Development Corporation (DevCo) were amalgamated, leaving one combined entity: GMHI.

The 2018 consolidated financial statements of GMHI included the full financial results for GMHI, GHESI and DevCo. The 2019 consolidated statements include the transactions related to the sale of GHESI, the operations of DevCo, and GMHI's share of Alectra's net income.

The 2019 GMHI financial statements were primarily prepared for the purpose of consolidation into the City's audited financial statements. An audit would have required a full set of financial statements and notes to be prepared and audited, an investment of staff time and audit fees that will not provide any value. This is a temporary deviation from the normal practice of presenting audited statements for 2019 only. Since the City took over the accounting and governance for GMHI beginning in 2019, there is now full transparency of all the transactional information, journal entries, and processes so this one-year change is considered low risk. Further, KPMG performed audit procedures over this entity as part of the City audit. For these reasons, a Notice to Reader engagement was completed for GMHI instead of an audit for 2019.

Please refer to Attachment-1, which includes the financial statements of GMHI for the year-ended December 31, 2019.

As of December 31, 2019 GMHI had assets totaling \$104.1 million (of which \$101.1 million is the investment in Alectra) and liabilities of \$14.6 million, the majority of

which is a deferred tax liability that would only be payable if GMHI divests of its shares in Alectra in the future.

GMHI's total comprehensive income for the year-ended December 31, 2019 is \$41.8 million, broken down as follows:

- Net income from the sale of GHESI shares to Alectra: \$40.4 million (gain on disposal of \$46.0 million less \$5.6 million in deferred tax expense).
- Net income from GMHI operations, management, and general administration: \$1.9 million (\$2.6 million in revenue less \$678 thousand in expenses). This is further broken down as:
 - District Energy operations – net loss of \$192 thousand
 - GMHI management and admin expenses - \$209 thousand
 - GMHI share of Alectra net income - \$2.3 million
- Hanlon Node wind down costs totaling \$505 thousand.

Financial Implications

The prudent management of the City's hydro utility company is an important asset that generates a healthy dividend to the City which in turn reduces the requirement of property tax increases to fund capital infrastructure renewal.

Report

Corporate structure

In 2019 GMHI's corporate structure changed significantly. As of the 2018 year-end, GMHI owned 100% of the shares of Guelph Hydro Electric Systems Inc. (GHESI) and 100% of the Shares of GMHI Development Corporation (DevCo). On January 1, 2019, GMHI amalgamated its shares of GHESI with Alectra for consideration of 4.63% of Alectra's shares. On June 30, 2019, GMHI and DevCo were amalgamated, leaving one combined entity: GMHI.

Accounting treatment

Prior to the amalgamation of GHESI with Alectra, GMHI controlled GHESI and DevCo, and therefore the assets, liabilities, revenues and expenses of GHESI and DevCo were fully consolidated into GMHI's financial statements.

With the amalgamation of GHESI with Alectra (January 1, 2019) and the amalgamation of GMHI and DevCo (June 30, 2019), GMHI now owns 4.63% of Alectra and has representation on the Board of Directors. Staff, in consultation with KPMG, have assessed GMHI as having significant influence over Alectra, and has accounted for the investment in Alectra using the equity method as prescribed by International Financial Reporting Standards.

The 2018 comparatives in the 2019 GMHI financial statements include the full operations of GHESI as well as DevCo, while the 2019 figures include the transactions related to the sale of GHESI, the operations of DevCo, and GMHI's share of Alectra's net income. It does not include dividends received in 2019.

This means that:

- GMHI's investment in Alectra was initially recorded at cost: the value of 4.63% of Alectra as of January 1, 2019 (\$101 million).

- GMHI's investment in Alectra was increased by 4.63% of Alectra's 2019 net income (\$2.27 million), and decreased by the dividends paid by Alectra to GMHI in 2019 (\$2.16 million).
- The investment revenue reported on the Statement of Comprehensive Income from Alectra is 4.63% of Alectra's net income for 2019 (\$2.27 million), not the amount of the dividends actually received (\$2.16 million).

Change in level of assurance

Since the simplification of GMHI's corporate structure, the financial statements are primarily prepared for the purpose of consolidation into the City's audited financial statements. An audit would have required a full set of financial statements and notes to be prepared and audited, an investment of staff time and audit fees that will not provide any value.

Since the City took over the accounting for GMHI beginning in 2019, there is now full transparency of all the transactional information, journal entries, and processes available to the auditor for GMHI. KPMG performed audit procedures over this entity as part of their work on the City's audited financial statements. For these reasons, a less expensive option of a Notice to Reader engagement was suggested by KPMG and accepted by staff for 2019 only. The 2019 financial statements have a Notice to Reader attached instead of an Independent Auditor's Report, and the statements have been simplified to consist of a Consolidated Balance Sheet, Consolidated Statement of Comprehensive Income, and Consolidated Statement of Changes in Equity. No cash flow statement nor notes to the financial statements have been prepared.

Amalgamation of GHESI with Alectra

GMHI received 4.63% of Alectra's shares as consideration for the amalgamation of GHESI and they were valued at \$101 million on January 1, 2019. The book value of GMHI's investment in GHESI was slightly under \$55 million at the time of the transaction, resulting in a gain on transaction of \$46 million.

There are no immediate tax impacts resulting from this gain due to an election made under section 85 of the Income Tax Act, however if GMHI divests of its shares in Alectra in the future there would be tax payable at that time which is reflected in the deferred tax liability of \$14.5 million reported on the balance sheet. Of this \$14.5 million, \$8.8 million would be refundable tax (recorded as an equity adjustment on the Statement of Changes in Equity), and \$5.6 million would be payable to CRA (recorded as deferred tax expense in the 2019 Statement of Comprehensive Income).

Comment on 2019 Results

Consolidated Statement of Comprehensive Income

GMHI's total comprehensive income for the year-ended December 31, 2019 is \$41.8 million, and is broken down as follows:

- Net income from the sale of GHESI shares to Alectra: \$40.4 million (gain on disposal of \$46.0 million less \$5.6 million in deferred tax expense).
- Net income from GMHI operations, management, and general administration: \$1.9 million (\$2.6 million in revenue less \$678 thousand in expenses). This is further broken down as:

- District Energy operations – net loss of \$192 thousand
- GMHI management and admin expenses - \$209 thousand
- GMHI share of Alectra net income - \$2.3 million
- Hanlon Node wind down costs totaling \$505 thousand which is trending below budget through 2020.

Dividends totaling \$2.16 million were received from Alectra in 2019, approximately \$1.4 million less than budgeted due to a one-time timing difference which resulted in GMHI's 2019 net income being lower than expected. For this reason, GMHI declared regular dividends to the City of only \$2.1 million in 2019 which was less than budgeted, but in excess of the 2019 income earned.

Consolidated Balance Sheet

As of December 31, 2019 GHMI had current assets totaling \$404 thousand and non-current assets totaling \$103.6 million, with the largest asset being GMHI's investment in Alectra with a December 31, 2019 value of \$101.1 million.

GMHI is owed \$2.5 million from the City. This consists of \$2.9 million receivable from the City for the special dividend loan, and is offset by a \$350 thousand operating loan from the City to GMHI for regular dividends paid to the City in excess of cash basis net income in 2019 due to the timing of dividends paid from Alectra to GMHI being different than expected. The GMHI Board approved depositing the proceeds from the GHESI special dividend in a City investment account in order to maximize investment earnings on these funds while they are held to fund the district energy transitional costs. This transaction has resulted in the inter-company loan as described.

Consolidated Statement of Changes in Equity

GMHI's total equity as of December 31, 2018 was \$72.1 million and increased by \$17.3 million by the end of 2019 with the changes being:

- Total comprehensive income for the year (increase of \$41.8 million)
- One-time special dividend as a result of the Alectra-GHESI merger (decrease of \$13.5 million)
- On-going normal dividends paid to the City (decrease of \$2.1 million)
- Refundable portion of deferred tax liability (decrease of \$8.8 million)

Financial Implications

The prudent management of the City's hydro utility company is an important asset that generates a healthy dividend to the City which in turn reduces the requirement of property tax increases to fund capital infrastructure renewal.

Consultations

The GMHI Board of Directors reviewed and approved the 2019 financial statements at the Board meeting on June 25, 2020.

Attachments

Attachment-1 GMHI Notice to Reader Financial Statements

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