

Financial Statements of

**LAKE HURON AREA
PRIMARY WATER
SUPPLY SYSTEM**

And Independent Auditors' Report thereon

Year ended December 31, 2019



KPMG LLP
140 Fullarton Street Suite 1400
London ON N6A 5P2
Canada
Tel 519 672-4800
Fax 519 672-5684

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Lake Huron Area Primary Water Supply System

Opinion

We have audited the financial statements of Lake Huron Area Primary Water Supply System (the "Entity"), which comprise:

- the statement of financial position as at December 31, 2019
- the statement of operations and accumulated surplus for the year then ended
- the statement of changes in net financial assets for the year then ended
- the statement of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2019, and its results of operations, its changes in net financial assets and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "**Auditors' Responsibilities for the Audit of the Financial Statements**" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.



In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.



- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

London, Canada

June 4, 2020

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Statement of Financial Position

December 31, 2019, with comparative information for 2018

	2019	2018
Financial assets		
Due from the Corporation of the City of London (note 3)	\$ 37,632,030	\$ 29,833,381
Trade and other receivables	673,067	1,908,629
Total financial assets	38,305,097	31,742,010
Financial liabilities		
Accounts payable and accrued liabilities	1,511,085	1,912,744
Accrued interest on long-term debt	43,209	49,253
Long-term debt (note 4)	6,855,465	8,065,505
Total financial liabilities	8,409,759	10,027,502
Net financial assets	29,895,338	21,714,508
Non-financial assets		
Tangible capital assets (note 5)	148,540,345	153,032,700
Prepaid expenses	243,388	202,510
Total non-financial assets	148,783,733	153,235,210
Accumulated surplus (note 6)	\$ 178,679,071	\$ 174,949,718

Commitments (note 8)

Contingent liabilities (note 9)

Subsequent events (note 11)

See accompanying notes to financial statements

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Statement of Operations and Accumulated Surplus

Year ended December 31, 2019, with comparative information for 2018

	Budget (note 10)	2019	2018
Revenues			
User charges	\$ 22,079,357	\$ 22,838,742	\$ 22,549,736
Investment income	22,000	832,509	506,101
Transfer payments:			
Provincial	-	-	674,777
Federal	-	-	1,077,471
Other	5,000	1,536	27,349
Total revenues	22,106,357	23,672,787	24,835,434
Expenses			
Salaries, wages and benefits	749,294	784,142	691,444
Materials and supplies	11,097,153	10,645,143	10,731,894
Contracted services	116,100	517,263	352,983
Rents and financial expenses	82,500	77,098	72,300
Interest on long-term debt (note 4)	162,889	162,889	181,625
Amortization of tangible capital assets (note 5)	-	7,543,440	7,425,041
Administrative charges	213,459	213,459	208,252
Total expenses	12,421,395	19,943,434	19,663,539
Annual surplus	9,684,962	3,729,353	5,171,895
Accumulated surplus, beginning of year (note 6)	174,949,718	174,949,718	169,777,823
Accumulated surplus, end of year (note 6)	\$ 184,634,680	\$ 178,679,071	\$ 174,949,718

See accompanying notes to financial statements

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Statement of Changes in Net Financial Assets

Year ended December 31, 2019, with comparative information for 2018

	Budget	2019	2018
	(note 10)		
Annual surplus	\$ 9,684,962	\$ 3,729,353	\$ 5,171,895
Acquisition of tangible capital assets	(15,127,000)	(3,051,085)	(2,774,993)
Amortization of tangible capital assets	-	7,543,440	7,425,041
	(5,442,038)	8,221,708	9,821,943
Change in prepaid expenses	-	(40,878)	4,154
Change in net financial assets	(5,442,038)	8,180,830	9,826,097
Net financial assets, beginning of year	21,714,508	21,714,508	11,888,411
Net financial assets, end of year	\$ 16,272,470	\$ 29,895,338	\$ 21,714,508

See accompanying notes to financial statements

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Statement of Cash Flows

Year ended December 31, 2019, with comparative information for 2018

	2019	2018
Cash provided by:		
Operating activities:		
Annual surplus	\$ 3,729,353	\$ 5,171,895
Items not involving cash:		
Amortization of tangible capital assets	7,543,440	7,425,041
Amortization of debenture discount	8,200	8,200
Changes in non-cash assets and liabilities:		
Due from the Corporation of the City of London	(7,798,649)	(6,327,849)
Prepaid expenses	(40,878)	4,154
Trade and other receivables	1,235,562	(1,281,184)
Accounts payable and accrued liabilities	(401,659)	(348,066)
Deferred revenue	-	(674,777)
Accrued interest on long-term debt	(6,044)	(4,943)
Net change in cash from operating activities	4,269,325	3,972,471
Capital activities:		
Purchase of tangible capital assets	(3,051,085)	(2,774,993)
Cash used in capital activities	(3,051,085)	(2,774,993)
Financing activities:		
Long-term debt repayments	(1,218,240)	(1,197,478)
Cash used in financing activities	(1,218,240)	(1,197,478)
Net change in cash flows	\$ -	\$ -

See accompanying notes to financial statements

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements

Year ended December 31, 2019

1. Nature of reporting entity

The final transfer order for Lake Huron Area Primary Water Supply System (the "Entity") was effective September 15, 2000, transferring assets along with any other real property to The Corporation of the City of London (the "Corporation") in trust to act as the Administering Municipality on behalf of the participating municipalities.

Under the transfer order, the works, properties and all assets, liabilities, rights and obligations of the system are conveyed, assigned and transferred to the Corporation as Trustee. Each of the benefitting municipalities, for so long as the municipality is serviced by the works has an undivided beneficial ownership interest in the works as tenant in common with all other municipalities jointly. The proportion that each municipality's interest bears to the total of all municipalities' interests shall be in the same ratio that the quantity of water supplied from the works to the municipalities at any time and from time to time bears to the total quantity of water supplied to all municipalities at such time. At present, the benefitting municipalities are The City of London, the Municipalities of Bluewater, South Huron, Lambton Shores, North Middlesex, Lucan-Biddulph, Middlesex Centre and Strathroy-Caradoc.

The transfer order established a joint board of management to govern the management of the water supply system. The joint board of management is comprised of eleven members appointed by the respective councils of participating municipalities. The Board composition is as follows:

Municipality	Members	Votes
The City of London	4	17
Bluewater	1	1
South Huron	1	1
Lucan-Biddulph	1	1
Lambton Shores	1	1
North Middlesex	1	3
Middlesex Centre	1	1
Strathroy-Caradoc	1	3

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

2. Significant accounting policies

The financial statements of the Entity are prepared by management, in accordance with Canadian generally accepted accounting principles as defined in the CPA Canada Public Sector Handbook – Accounting. Significant accounting policies are as follows.

(a) Accrual accounting

Sources of financing and expenses are reported on the accrual basis of accounting.

(b) Non-financial assets

Non-financial assets are not available to discharge existing liabilities and are held for use in the provision of services. They have useful lives extending beyond the current year and are not intended for sale in the ordinary course of operations.

i) Tangible capital assets

Tangible capital assets are recorded at cost which includes amounts that are directly attributable to acquisition, construction, development or betterment of the asset. The cost, less residual value, of the tangible capital assets, excluding land, are amortized on a straight line basis over their estimated useful lives as follows:

Asset	Useful Life - Years
Buildings and building improvements	15 – 40
Vehicles	5 – 15
Machinery and equipment	7 – 20
Water infrastructure	10 – 60
Computers	3

Annual amortization is charged in the year of acquisition and in the year of disposal using the half year rule. Assets under construction are not amortized until the asset is available for productive use.

ii) Interest capitalization

The interest costs associated with the acquisition or construction of a tangible capital asset are not capitalized.

(c) Revenue recognition

The Entity recognizes revenue when water is drawn by each customer, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable.

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

2. Significant accounting policies (continued)

(d) Government transfers

Government transfer payments to the Corporation are recognized in the financial statements in the year in which the payment is authorized and the events giving rise to the transfer occur, performance criteria are met, and a reasonable estimate of the amount can be made. Funding that is stipulated to be used for specific purposes is only recognized as revenue in the fiscal year that the related expenses are incurred or services performed. If funding is received for which the related expenses have not yet been incurred or services performed, these amounts are recorded as a liability at year end.

(e) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Significant items subject to such estimates and assumptions include the valuation allowances for receivables and useful lives assigned to tangible capital assets.

Actual results could differ from those estimates.

(f) Budget figures

Budget figures have been provided for comparison purposes. Given differences between the budgeting model and generally accepted accounting principles established by the Public Sector Accounting Board ("PSAB"), certain budgeted amounts have been reclassified to reflect the presentation adopted under PSAB.

(g) Liability for contaminated sites

Under PS 3260, liability for contaminated sites are defined as the result of contamination being introduced in air, soil, water or sediment of a chemical, organic, or radioactive material or live organism that exceeds an environmental standard. This Standard relates to sites that are not in productive use and sites in productive use where an unexpected event resulted in contamination.

(h) Related party disclosures

The Entity adopted Public Sector Accounting Board Standard PS 2200 *Related Party Transactions* effective for fiscal periods beginning on or after April 1, 2017. The standard defines related party and provides disclosure requirements. Disclosure is only required when the transactions or events between related parties occur at a value different from what would have been recorded if they were not related and the transactions could have a material financial impact on the financial statements. The standard also requires disclosure of related party transactions that have occurred where no amounts have been recognized. The Entity adopted this standard on a prospective basis and there were no adjustments as a result of the adoption of this standard.

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

2. Significant accounting policies (continued)

(i) Inter-entity transactions

The Entity adopted Public Sector Accounting Board standard PS 3420 *Inter-entity Transactions* effective for fiscal periods beginning on or after April 1, 2017. The standards specifies how to account for transactions between public sector entities within the government reporting entity.

Transactions undertaken on similar terms and conditions to those adopted if the entities were dealing at arm's length are recorded at the exchange amount. Transfers of an asset or liability at nominal or no consideration is recorded by the provider at the carrying amount and the recipient has the choice of using either the carrying amount or fair value. Cost allocations are reported using the exchange amount and revenues and expenses are reported on a gross basis. Unallocated costs for the provision of goods or services may be recorded by the recipient at the carrying amount or fair value unless otherwise dictated by policy, accountability structure or budget practice.

All other transactions are measured at the carrying amount.

The Entity adopted this standard on a prospective basis and there were no adjustments as a result of the adoption of this standard.

3. Due from the Corporation of the City of London

As the Administering Municipality, the Corporation manages the daily operations of the Entity. The Corporation maintains a separate general ledger on behalf of the Entity. All funds are paid and received through the Corporation's bank account and are held for use by the Entity.

4. Long-term debt

(a) Long-term debt is stated as follows:

	2019	2018
Long-term debt assumed by The Corporation of the City of London, as administering municipality, on behalf of the Lake Huron Area Primary Water Supply System, with semi-annual interest payments:		
(a) at rates ranging from 2.50% to 3.20%, maturing September 2022.	\$ 571,075	\$ 752,225
(b) at rates ranging from 2.65% to 3.80%, maturing September 2023.	647,370	798,930
(c) at rates ranging from 0.95% to 2.25%, maturing March 2025.	5,346,840	6,194,298
(d) at rates ranging from 1.15% to 2.85%, maturing March 2027.	331,212	369,285
Total long-term debt	6,896,497	8,114,738
Less: Unamortized debenture discount	(41,032)	(49,233)
Net long-term debt	\$ 6,855,465	\$ 8,065,505

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

4. Long-term debt

(b) The long-term debt repayment schedule is as follows:

2020	\$	1,239,448
2021		1,261,262
2022		1,283,326
2023		1,106,232
2024		951,752
2025 & beyond		1,054,477

(c) Total charges for the year for long-term debt which are reported on the Statement of Operations and Accumulated Surplus are as follows:

	2019	2018
Interest	\$ 154,688	\$ 173,425
Amortization of debenture discount	8,201	8,200
	\$ 162,889	\$ 181,625

5. Tangible capital assets

Cost	Balance at December 31, 2018	Additions	Disposals	Balance at December 31, 2019
Land	\$ 1,843,513	\$ 545,549	\$ -	\$ 2,389,062
Buildings and building improvements	55,553,348	303,521	55,590	55,801,279
Machinery and equipment	42,888,999	1,601,662	464,883	44,025,778
Vehicles	32,425	-	20,898	11,527
Water infrastructure	118,418,737	241,541	-	118,660,278
Computers	85,620	1,217	-	86,837
Assets under construction	367,691	591,798	234,203	725,286
Total	\$ 219,190,333	\$ 3,285,288	\$ 775,574	\$ 221,700,047

Accumulated Amortization	Balance at December 31, 2018	Amortization expense	Disposals	Balance at December 31, 2019
Land	\$ -	\$ -	\$ -	\$ -
Buildings and building improvements	15,911,689	2,202,742	55,590	18,058,841
Machinery and equipment	20,925,399	3,070,999	464,883	23,531,515
Vehicles	23,369	1,646	20,898	4,117
Water infrastructure	29,282,867	2,239,309	-	31,522,176
Computers	14,309	28,744	-	43,053
Assets under construction	-	-	-	-
Total	\$ 66,157,633	\$ 7,543,440	\$ 541,371	\$ 73,159,702

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

5. Tangible capital assets (continued)

	Net book value December 31, 2018	Net book value December 31, 2019
Land	\$ 1,843,513	\$ 2,389,062
Buildings and building improvements	39,641,659	37,742,438
Machinery and equipment	21,963,600	20,494,263
Vehicles	9,056	7,410
Water infrastructure	89,135,870	87,138,102
Computers	71,311	43,784
Assets under construction	367,691	725,286
Total	\$ 153,032,700	\$ 148,540,345

(a) Assets under construction

Assets under construction with a net book value of \$725,286 (2018 - \$367,691) have not been amortized. Amortization of these assets will commence when the asset is available for productive use.

(b) Tangible capital assets disclosed at nominal values

Where an estimate of fair value could not be made, the tangible capital asset was recognized at a nominal value. Land is the only category where nominal values were assigned.

(c) Write-down of tangible capital assets

There were no write-downs in tangible capital assets during the year (2018 – nil).

6. Accumulated surplus

Accumulated surplus consists of individual fund surplus and reserve funds as follows:

	2019	2018
Surplus:		
Invested in tangible capital assets	\$139,069,937	\$142,376,307
Total surplus	139,069,937	142,376,307
Reserve funds set aside for specific purpose by the Board:		
Infrastructure renewal - water operations	39,609,134	32,573,411
Total reserve funds	39,609,134	32,573,411
	\$178,679,071	\$174,949,718

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

7. Financial instruments

- (a) The carrying values of due from the Corporation of the City of London, trade and other receivables and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments.

The fair value of long-term debt approximates its carrying value as interest rates are similar to current market rates of interest available to the Entity.

- (b) Financial risks

The Entity is not exposed to any significant interest, foreign currency or credit risks arising from its financial instruments.

8. Commitments

Derivatives

The Entity has the following derivative:

- Contract with one block negotiated May 5, 2017, with a daily electricity purchase of 24 megawatt hours. Covering the period of November 1, 2018 to August 31, 2021, remaining contract cost at December 31, 2019 is \$431,587 (2018 - \$689,832 under contract expired October 31, 2019).

This derivative contract was purchased to ensure price certainty for 26% of the Entity's electricity needs over the term of the contract. The value of the contract is not reflected as an asset or liability in these financial statements.

9. Contingent liabilities

There are certain claims pending against the Entity as at December 31, 2019. The final outcome of these claims cannot be determined at this time, however management believes that settlement of these matters will not materially exceed amounts recorded in these financial statements.

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

10. Budget data

Budget data presented in these consolidated financial statements are based upon 2019 operating budget approved by the joint board of management. Adjustments to budgeted values were required to provide comparative budget values based on the full accrual basis of accounting. The chart below reconciles the approved budget with the budget figures as presented in these financial statements.

	Budget
Revenues	
User charges	\$ 22,079,357
Municipal Revenues - Other	27,000
Total revenues	22,106,357
Expenses	
Personnel Costs	681,294
Administrative Expenses	88,000
Financial Expenses - Other	310,000
Financial Expenses - Interest and Discount on LTD	162,889
Financial Expenses - Debt Principal Repayments	1,218,241
Financial Expenses - Transfers to Reserves and Reserve Funds	8,466,721
Purchased Services	609,100
Materials and Supplies	10,321,903
Furniture and Equipment	34,750
Other Expenses	213,459
Recovered Expenses	-
Total expenses	21,106,357
Net surplus as per Budget	\$ -
PSAB Reporting Requirements:	
Transfers to Reserves and Reserve Funds	\$ 8,466,721
Debt principal repayments	1,218,241
Net PSAB Budget surplus as per Financial Statements	\$ 9,684,962

LAKE HURON AREA PRIMARY WATER SUPPLY SYSTEM

Notes to Financial Statements (continued)

Year ended December 31, 2019

11. Subsequent events

Subsequent to December 31, 2019, the COVID-19 outbreak was declared a pandemic by the World Health Organization and has had a significant financial, market and social dislocating impact.

At the time of approval of these financial statements, the entity has experienced the following indicators of financial implications and undertaken the following activities in relation to the COVID-19 pandemic:

- Due to the Province of Ontario's declaration of a State of Emergency Order and the temporary closure of non-essential business and restrictions in activities, consumption within the municipalities served by the water system has moderately declined.
- Lower water demand volumes within the municipalities may result in lower expenditures
- The Regional Water Supply office has remained open but reduced their staffing compliment on premises from March 18, 2020 to the date of the auditors' report based on public health recommendations
- Implemented voluntary working from home strategy in service delivery
- Modifications to shift coverage and work-isolations to minimize risks to operating staff at the water treatment plants

At this time, these factors present uncertainty over future cash flows, may cause significant changes to the assets or liabilities and may have a significant impact on future operations. An estimate of the financial effect is not practicable at this time.