

**REPORT TO HOSPITALS AND HOUSING COMMITTEE
MEETING OF WEDNESDAY, MAY 01, 2019**

SUBJECT **Capital Regional Hospital District 2018 Audit Findings Report and Audited Financial Statements**

ISSUE

To receive the Capital Regional Hospital District (CRHD) 2018 Audit Findings Report and approve the Audited Financial Statements.

BACKGROUND

Section 17 of the *Hospital District Act* and Section 814 of the *Local Government Act* require that audited financial statements be prepared each year. The 2018 Financial Statements have been prepared by management in accordance with Canadian public sector accounting standards (PSAS), as recommended by the Public Sector Accounting Board (PSAB).

The CRHD was established by the provincial government (*Hospital District Act*) to provide the local share of capital funding for healthcare infrastructure in the capital region. CRHD shares the same boundaries, directors and administrative staff as the Capital Regional District (CRD).

Partnering with Island Health and community stakeholder agencies, the CRHD supports a healthy region by investing in healthcare service and capital strategic priorities including upgrades and renewal of existing health facilities and medical equipment, replacement of existing buildings, new projects and expansion of existing facilities. Financial activities consist of raising 30-40% of the costs of approved capital projects and purchases as proposed annually by the Island Health Authority. More recently, the CRHD has taken an active role in the development and construction of capital projects and is currently building the Summit at Quadra Village, a residential care facility to be leased and operated by Island Health. At December 31, 2018, construction was 60% completed, and 31% of total capital budget was expended in 2018.

To ensure accountability for CRHD expenditures, the CRD provides oversight and review of facility projects and expenditures for major capital projects (greater than \$2 million), minor capital (between \$100,000 and \$2 million), healthcare equipment and non-traditional projects. The CRD also works through community-based networks to identify the need for non-traditional capital funding requirements in the areas of primary and residential-based healthcare services.

Under PSAB regulations, government organizations are required to present four statements with accompanying notes:

1. Statement of Financial Position
2. Statement of Operations
3. Statement of Change in Net Debt
4. Statement of Cash Flows

In addition to the required statements, the 2018 Financial Statements include the following audited schedule:

A. Grants to District Hospitals

Attached as Appendix 1 are the CRHD 2018 Audited Financial Statements.

Independent Auditor's Draft Report

Management is responsible for the preparation and fair presentation of CRHD financial statements in accordance with Canadian public sector accounting standards, and for 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.

KPMG LLP is responsible for expressing an opinion to the Board based on the results of their audit. The Auditor's opinion is expressed in Appendix 2. In KPMG's opinion, the financial statements present fairly, in all material respects, the financial position of the Capital Regional Hospital District as at December 31, 2018, and its results of operations, its change in net debt, and its cash flows for the year then ended is in accordance with Canadian public sector accounting standards.

The Audit Findings Report from KPMG (Appendix 2) summarizes the responsibilities of the audit firm, scope of investigations, and the audit results. The Audit Findings Report includes the following highlights:

Adjustments and differences identified during the audit are categorized as "Corrected adjustments" or "Uncorrected differences". One difference identified from the 2017 fiscal year remains uncorrected. This difference relates to Summit debt issuance costs recognized in fiscal year 2017, in the amount of \$122,500, that were recorded as an expense rather than being amortized over the 25 year term of the debt (\$4,900/yr). This difference will remain as an uncorrected difference until it declines in value and becomes less than the audit misstatement posting threshold (2018: \$35,000). Leaving the entry unadjusted resulting in a consistent treatment of debt issuance costs being expensed in the year incurred. KPMG concurs with management's representation and accordingly, the difference has no effect on the auditor's report.

Financial Statements

The CRHD partners with Island Health and other community stakeholder agencies to develop and improve healthcare facilities and to provide capital funding by way of borrowing funds and in turn providing capital grant funding for various projects.

The Statement of Financial Position and the Statement of Operations form the basis of the audited financial statements and are similar to the Balance Sheet and Income Statement, respectively, in private organizations. The Financial Statements are prepared in accordance with Canadian public sector accounting standards (PSAS).

Highlights

1. Statement of Financial Position

The Statement of Financial Position presents the financial position of an entity at a given date. It is comprised of three main components: financial assets, financial liabilities, and non-financial assets. As the nature of business for CRHD is to secure funds and provide capital funding for projects; the CRHD typically reports a net debt and accumulated deficit position in the Statement of Financial Position. At December 31, 2018, the accumulated deficit was \$68.4M (2017: \$87.5M) which represents the total financial assets less total financial liabilities and non-financial assets. The accumulated deficit decreased by \$19.2M (22%) over prior year.

- Financial assets of \$57M in 2018 are comprised mainly of cash and cash equivalents, investments, and a MFA debt reserve fund. In 2018, there was a net decrease of \$7.2M in cash and cash equivalents and a net decrease of \$14M in investments, both primarily due to the construction of Summit, the new residential care facility. The capital budget for Summit, a three-year project, is \$86.4M, with \$26.7M (31%) of this budget being expended in 2018. In 2017, CRHD secured borrowing from the MFA, in the amount \$61.3M to fund the Summit project. Funds not yet required for construction have been placed in investments until needed.
- Financial Liabilities of \$184.3M consist of accounts payable and long term debt. The accounts payable balance increased by \$3.4M over prior year; this increase is related to an increase in construction contract holdbacks relating to the Summit project and increased construction expense over prior year.
- Non-Financial Assets of \$58.5M consist of tangible capital assets and the increase of \$26.7M from prior year is attributed to Summit project construction. Additional detail is presented in Note 6 of the 2018 Financial Statements.

Appendix 3 provides a detailed summary of variances year-over-year greater than \$100,000 and 10% on the Statement of Financial Position. The threshold is relative to the size and particular operations of the entity.

2. Statement of Operations

The Statement of Operations provides important information about an entity's accountability for its operations and the related achievement of its objectives. It reports the surplus or deficit from operations in the accounting period and measures, in monetary terms, the change in accumulated operating surplus or deficit in the period. The statement presents the cost of services provided and the revenue recognized in operations for the accounting period and the difference between them. Gross revenues are disclosed to ensure that the total magnitude of the CRHD's revenue raising is reflected in the financial statements; gross expenses are disclosed by function and major program.

- Revenue for the year decreased by \$3.6M (9%), to \$31.9M which can be attributed to the gain on sale of Carey Road land in 2017 (\$5M), which is offset by increased interest income in 2018. No land sales were executed in 2018. Interest earnings are linked to the CRHD's investment strategy and strategic placement of working capital and increased by \$721k over prior year due to cash and investments being held in a rising interest rate market.

- Grants to District Hospitals in the year were \$7.4M, a decrease of \$1.6M (18%) over prior year. Grants to the district hospitals vary year-over-year depending on the timing of projects and grant-claim submissions of various capital projects. The actual expense includes the annual grant expense from the revenue fund as well as the capital fund expenditures where debt was incurred to finance major projects.
- The accumulated deficit represents the sum of all of the annual surpluses and deficits reported by the CRHD. In 2018, operations resulted in an annual surplus of \$19.2M, this reduced the accumulated deficit from \$87.5M in prior year, to \$68.4 million at December 31, 2018.

Appendix 4 provides a detailed summary of variances year-over-year greater than \$100,000 and 10% on the Statement of Operations.

3. Statement of Change in Net Debt

Net debt is the remainder of liabilities less financial assets. The accumulated surplus/deficit is the remainder of non-financial assets less net debt. The Statement of Change in Net Debt is primarily designed to explain the difference between the CRHD's annual surplus reported on the Statement of Operations and the change in net debt. The Statement of Change in Net Debt reports the amount that expenditures in the accounting period are met by revenues recognized, at both the beginning and end of the fiscal year.

In 2018, the CRHD's net debt position \$126.9M, increased by \$7.5M over prior year. The primary reason for the change in net debt in 2018 is the acquisition of tangible capital assets (\$26.7M) relating to Summit, which is offset by the annual surplus of \$19.2M.

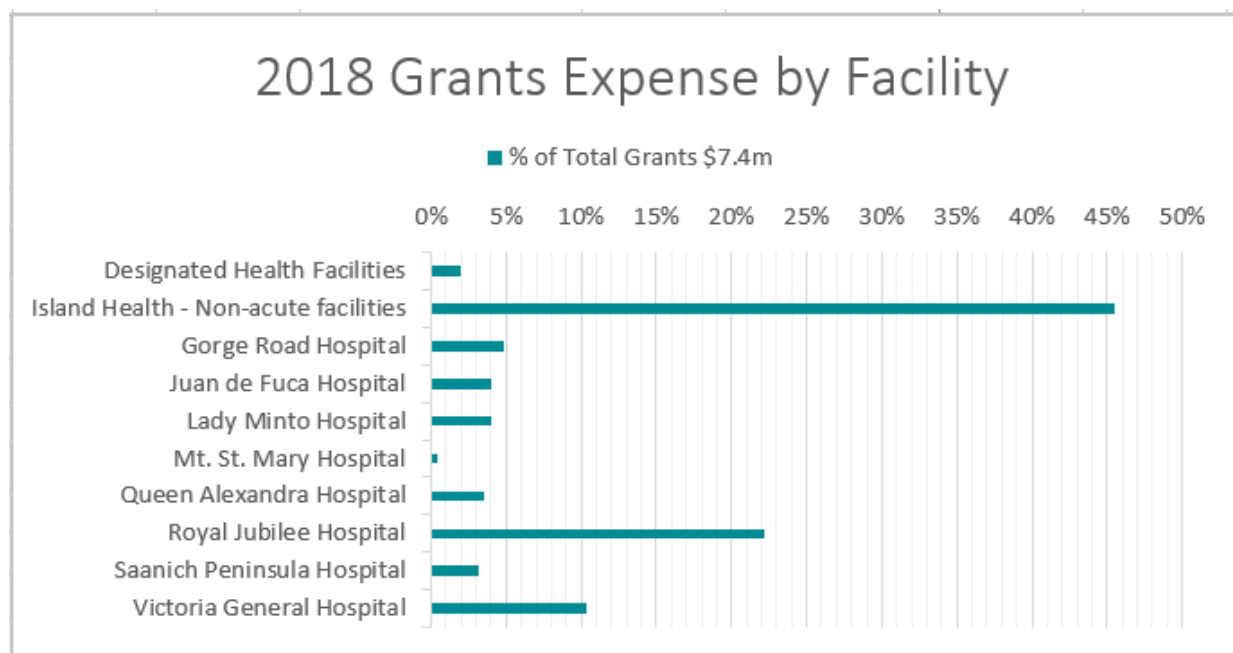
4. Statement of Cash Flows

The Statement of Cash Flows reports the sources and uses of cash during the period. Cash flows are summarized by four distinct categories: operating activities, capital activities, investing activities and financing activities. The net change in cash and cash equivalents in 2018 was a decrease of \$7.2M and is a result of surplus generating \$17.5M of cash, that was used for the acquisition of tangible capital assets (\$26.7M), investing activities (\$14.0M), and financing activities (\$11.9M) that included additions and repayments of long-term debt.

5. Schedule (Audited)

A. Schedule of Grants to District Hospitals

Schedule A summarizes the amounts raised for capital grants that are approved in conjunction with the annual budget and capital plan and the expenditures of those funds during the year. CRHD cost shares between 30-40% of approved project costs and the CRHD share of authorized projects at December 31, 2018, are \$55.5M (2017: \$51.2M). This includes: equipment grants, major capital projects (Unit Dose Medication Distribution Project and St. Anthony's Westshore Urgent Primary Care Project) and various minor capital projects that are cash flowed over several years. Capital grant expenses in the year were \$7.4M and the value of projects completed during the year was \$7.6M (inclusive of the \$150k NTP grant). The 2018 total grants expense is illustrated by facility in the graph below.

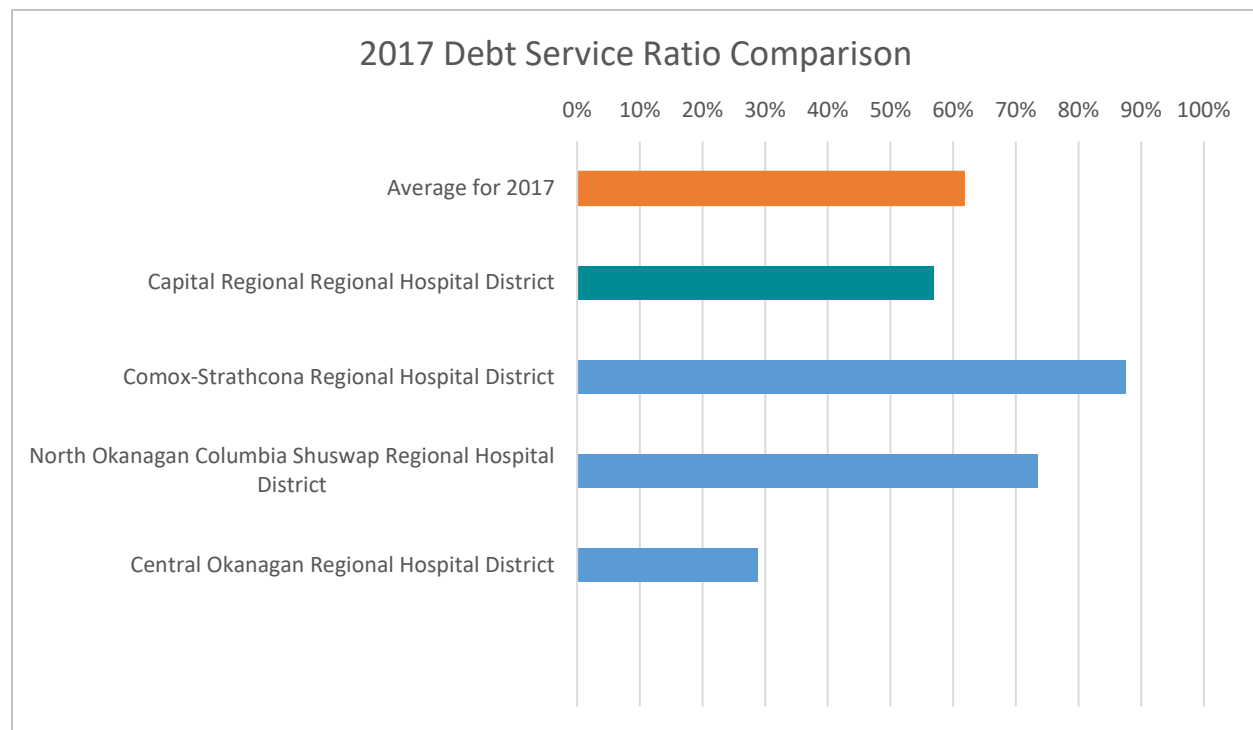


6. Financial Indicators

Financial indicators are metrics used to quantify current conditions and to forecast financial and economic trends. They can be used as a tool to evaluate overall financial condition of the entity. The following indicators are relevant to CRHD's performance and financial sustainability.

6.1 Debt service costs as a percentage of revenue (Debt Service Ratio)

The debt service ratio is an indicator of the percentage of revenue that is committed to the payment of interest and principal on temporary and long-term debt. A high percentage indicates greater use of revenue for the repayment of debt. As the CRHD's primary mandate is to secure borrowing and provide capital grants for health facility infrastructure, a high debt servicing ratio is expected for the Hospital District. Debt servicing costs include payments made for principal retirement and interest charges in the current year. CRHD's debt servicing costs as a percentage of revenue at December 31, 2018 is 63% (2017: 57%). Based on the 2017 financial results of other Hospital Districts in British Columbia, the average debt service costs as a percentage of revenue is 62%. Current year comparison data is not yet available.



6.2 Current assets versus current liabilities (Current Ratio)

The current ratio is a measure of the liquidity of an organization, meaning the CRHD's ability to meet current obligations through the use of current assets (cash, accounts receivable, short-term investments). A high ratio indicates a greater ability to meet budgeted and unexpected expenditures. The CRHD's current ratio as at December 31, 2018, is 5.9 to 1 (2017: 13.4 to 1), indicating CRHD's current assets are sufficient to pay current liabilities 5.9 times.

6.3 Interest costs as a percentage of total revenues (Interest Coverage Ratio)

This ratio is an indicator of the percentage of revenue committed to the payment of interest on temporary and long-term debt. A high percentage indicates greater use of revenues for servicing interest on outstanding debt. The CRHD's interest coverage ratio at December 31, 2018 is 3.6, meaning the CRHD's revenue is sufficient to repay interest expense 3.6 times over (2017: 4.2).

ALTERNATIVES

Alternative 1

That the Hospitals and Housing Committee recommend to the Capital Regional Hospital District Board:

That the Capital Regional Hospital District 2018 Audit Findings Report be received and the Capital Regional Hospital District 2018 Audited Financial Statements be approved.

Alternative 2

That the Hospital and Housing Committee refer this report back to staff for additional information.

FINANCIAL IMPLICATIONS

The 2018 financial statements are a statutory requirement prepared in accordance to PSAB standards. The statements have been audited by KPMG and have been found to present fairly, in all material aspects, the financial position at December 31, 2018. Overall the 2018 statements reflect a decrease in the accumulated deficit of \$19.2M which is primarily attributed to the Summit capital project, utilization of the structured financing model for Summit and strategic placement of CRHD working capital. The financial viability of the organization is discussed in the financial indicators. In 2018, the Summit project increased tangible capital assets on the CRHD books by \$26.7M, while net debt increased by \$7.5M.

The audited financial statements are ready for approval; Board approved financial statements are required to be filed with the Ministry of Health and Municipal Finance Authority.

CONCLUSION

Board approval of the CRHD 2018 Audited Financial Statements is required by the *Hospital District Act*, and the *Local Government Act*. Audited financial statements must be available for the Ministry of Health and Municipal Finance Authority. KPMG has completed the annual audit and as noted in the Auditor's Report, it is the Auditor's opinion that these Financial Statements present fairly the financial position of CRHD at December 31, 2018, and the results of the financial activities for the year then ended in accordance with Canadian Public Sector Accounting Standards.

RECOMMENDATION

That the Hospitals and Housing Committee recommend to the Capital Regional Hospital District Board:

That the Capital Regional Hospital District 2018 Audit Findings Report be received and the Capital Regional Hospital District 2018 Audited Financial Statements be approved.

Submitted by:	Agnes Piotrowski, CPA, CA Manager, Major Projects
Concurrence:	Kevin Lorette, P.Eng, MBA, General Manager, Planning & Protective Services
Concurrence:	Nelson Chan, MBA, CPA, CMA, Chief Financial Officer
Concurrence:	Robert Lapham, MCIP, RPP, Chief Administrative Officer

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Attachments:

Appendix 1, 2018 CRHD Audited Financial Statements

Appendix 2, 2018 CRHD Audit Findings Report

Appendix 3, 2018 Detailed Variance analytics (Statement of Financial Position)

Appendix 4, 2018 Detailed Variance analytics (Statement of Operations)