

# Memo



**Date:** April 29, 2021

**To:** Audit Committee

**From:** Genelle Davidson, Divisional Director, Financial Services

**Subject:** Audit Committee Review of Kelowna International Airport's December 31, 2020 Audited Financial Statements

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## **Purpose of Kelowna International Airport's Financial Statements**

Consistent with the City of Kelowna's (the City) other business unit funds, Kelowna International Airport (the Airport or YLW) prepares financial statements in accordance with Canadian public sector accounting standards, which are consolidated into the City's consolidated audited financial statements.

In addition, a portion of the Airport is located on land that is leased from the Federal Government. In accordance with the amendment made in 1993 to clause 34 of the lease agreement between the Minister of Transport and the City of Kelowna, "*The [City of Kelowna] shall submit within 120 days after the [City of Kelowna's] fiscal year end, a statement of revenues and expenditures relating to the Airport for that period, a statement of surplus for that period, a statement of source and application of all funds including the revenues deposited in the Airport Fund for that period, and a balance sheet as of the end of that period all prepared according to the Canadian Institute of Chartered Accountants (CICA) generally accepted accounting principles, and audited according to CICA generally accepted auditing standards and certified by an independent auditor, who is a member or a partnership whose partners are members in good standing of the Canadian Institute of Chartered Accountants.*" As a result, the Airport's stand-alone financial statements are audited on an annual basis.

## **The Airport Financial Statements**

The Airport's Financial Statements include the financial results for each of the Airside, Groundside, Terminal and Airport Improvement Fee (AIF) funds and provide an aggregated view of the financial position and overall financial well-being of the Airport.

The Airport's financial statements consist of the:

- Statement of Financial Position;
- Statement of Operations and Accumulated Surplus;
- Statement of Changes in Net Financial Assets;
- Statement of Cash Flows; and
- Notes to the Financial Statements.

## **Statement of Financial Position**

The Statement of Financial Position presents the Airport's cumulative net financial assets, non-financial assets and accumulated surplus as at December 31, 2020 and December 31, 2019.

The Airport's net financial assets are equal to its financial assets less its liabilities. The Airport's financial assets consist of cash and cash equivalents, accounts receivable and portfolio investments, and are the financial resources available to discharge the Airport's existing liabilities and finance its future operations. The Airport's liabilities consist of accounts payable, performance deposits, deferred revenue, mortgage payable, long term payable and debenture debt.

The Airport's non-financial assets are employed to provide future services and consist of prepaid expenses, inventory, work in progress and tangible capital assets.

The Airport's accumulated surplus is the total that the Airport's cumulative revenues have exceeded its cumulative expenses. The accumulated surplus is equal to the sum of the net financial assets and non-financial assets.

### **Net Financial Assets**

The Airport's financial assets of \$34.8 million ("M") exceeded its liabilities of \$19.4M by \$15.4M at December 31, 2020. As a result, the Airport has sufficient financial assets to settle its existing liabilities as at December 31, 2020. The Airport's net financial assets increased \$1.1M from \$14.3M at December 31, 2019 to \$15.4M at December 31, 2020, mainly due to a \$2.6M increase in cash, a \$2.1M decrease in debenture debt, and a \$1.0M decrease in accounts payable, a \$0.9M decrease in mortgage payable, which were partially offset by a \$2.4M decrease in accounts receivable, a \$2.4M decrease in investments, and a \$1.1M increase in long term debt.

### **Financial Assets**

The Airport's financial assets have decreased by approximately \$2.2M from \$37.0M at December 31, 2019 to \$34.8M at December 31, 2020 due to the movements outlined below.

i. Cash and cash equivalents

Cash and Cash equivalents represent funds held in the City of Kelowna pooled funds either as cash or short-term investments with maturities of 90 days or less from the date of acquisition. The Airport's cash and cash equivalents have increased \$2.6M from \$1.1M to \$3.7M between December 31, 2019 and December 31, 2020. Further details on these movements have been included below under the discussion of the Airport's Statement of Cash Flows.

ii. Accounts receivable

The Airport's account receivables decreased approximately \$2.4M from \$4.4M at December 31, 2019 to \$2.0M at December 31, 2020. This was mainly due to a \$2.2M decrease in Trade receivables, which was mainly due to revenues being lower in 2020 than in 2019 as a result of the significant, negative impact of COVID-19 on the Airport's operations.

iii. Portfolio investments

Portfolio investments represent funds invested from the City of Kelowna's pooled funds and consist of Municipal Finance Authority bonds/intermediate funds, Provincial and bank issued accrual notes and debentures and guaranteed investment certificates and deposit notes. The Airport's portfolio investments decreased by \$2.4M between December 31, 2019 and December 31, 2020, as portfolio investments were used to help fund expenditures.

Liabilities

The Airport's liabilities have decreased \$3.3M from \$22.7M at December 31, 2019 to \$19.4M at December 31, 2020, due to the movements outlined below:

i. Accounts payable

The Airport's accounts payable decreased \$1.0M from \$3.9M at December 31, 2019 to \$2.9M at December 31, 2020 mainly due to a \$1.0M decrease in trade payables. The decrease in trade payables was mainly due to lower expenditures in 2020 resulting from the implementation of substantial measures to help reduce costs and mitigate the significant, negative impact of COVID-19.

ii. Performance deposits

The Airport's performance deposits mainly consist of deposits from airlines. The Airport's performance deposits decreased \$0.1M from \$0.3M to \$0.2M between December 31, 2019 and December 31, 2020. The \$0.1M reduction was mainly due to an airline utilizing a portion of its deposit to pay outstanding amounts due. Due to the significant reduction in operations as a result of COVID-19, the remaining deposit on hand remains sufficient.

iii. Deferred revenue

The Airport's deferred revenue consists of cash received for services not yet provided with regards to aircrew parking, taxi, shuttle and limo licenses, advertising, annual aircraft parking and leases. The Airport's deferred revenue decreased \$0.3M from \$0.5M at December 31, 2019 to \$0.2M at December 31, 2020, mainly due to there being deferred revenues related to grants at December 31, 2019, and there being no such deferred revenues at December 31, 2020.

iv. Mortgage payable

In 2016, the Airport acquired Shadow Ridge golf course in exchange for \$900k at that point in time and \$900k per year for five years. The \$900k decrease in the mortgage payable between December 31, 2019 and December 31, 2020 is due to the annual payment that was made in 2020 and the \$900k balance payable at December 31, 2020 represents the last annual payment to be made.

v. Long term payable

The Airport's new long term payable mainly consists of the 2020 municipal services and administration fees payable to the City of Kelowna (the Municipal Fee). Due to the significant, negative impact of COVID-19, \$1.0M of the \$1.5M 2020 Municipal Fee will be paid between 2021 and 2023. This long term payable is non-interest bearing.

vi. Debenture debt

The Airport's debenture debt consists of four debt issuances from the Municipal Finance Authority as outlined below. The \$2.1M decrease in debenture debt from \$16.2M at December 31, 2019 to \$14.1M at December 31, 2020 was due to the repayment of principal associated with debenture debt issued between 2015 and 2017.

Date of Issue	Term (Years)	Amount of Issue	Sinking Fund Balance	Net Debt at December 31, 2020
October 2015	10	7,500,000	3,428,000	4,072,000
April 2016	10	3,500,000	1,258,000	2,242,000
October 2016	10	3,000,000	1,095,000	1,905,000
April 2017	10	8,000,000	2,157,000	5,843,000
<b>Total</b>		<b>\$22,000,000</b>	<b>\$7,938,000</b>	<b>\$14,062,000</b>

Non-financial Assets

The Airport's non-financial assets have decreased \$2.5M from \$153.8M at December 31, 2019 to \$151.3M at December 31, 2020 due to the movements outlined below:

i. Prepaid expenses

The Airport's prepaid expenses decreased \$0.1M from \$0.2M to \$0.1M between December 31, 2019 and December 31, 2020. This decrease was mainly due to the significant reduction in expenditures combined with a change in the timing of payments, both of which were in response to the significant, negative impact of COVID-19.

ii. Inventory

The Airport's inventory consists of chemicals, fuel and supplies. Inventory decreased \$0.1M from \$0.3M at December 31, 2019 to \$0.2M at December 31, 2020 mainly due to inventory purchases being made just in time to help mitigate the significant, negative impact of COVID-19.

iii. Work in progress

The Airport's work in progress represents the cost of projects that are underway at year end and are not yet eligible to be capitalized to tangible capital assets. Work in progress decreased \$500k from \$7.0M to \$6.5M between December 31, 2019 and December 31, 2020 due to the addition of \$3.3M in construction costs, which was more than offset by the transfer of \$3.8M of costs to tangible capital assets upon the completion of construction projects during the year ended December 31, 2020.

iv. Tangible capital assets

Tangible capital assets consist of land, land improvements, buildings, infrastructure, and machinery and equipment. The Airport's tangible capital assets decreased \$1.9M from \$146.3M at December 31, 2019 to \$144.4M at December 31, 2020 due to additions of \$5.8M (transfer from work in progress represents \$3.8M) which were partially offset by the recognition of \$7.7M in amortization. The \$5.8M of additions mainly consisted of (i) the long-term and valet parking lots (\$2.8M), (ii) the purchase of land for future expansion (\$0.7M), (iii) the purchase of equipment (\$0.6M), (iv) capital upgrades for the air terminal building (\$0.4M), (v) capital upgrades for the combined operations building (\$0.4M), (vi) the pavement rehabilitation project (\$0.3M), (viii) the apron rehabilitation project (\$0.3M), and (ix) a number of smaller projects.

Accumulated Surplus

The Airport's accumulated surplus decreased by \$1.5M from \$168.2M at December 31, 2019 to \$166.7M at December 31, 2020. The Airport's cumulative revenues exceed its cumulative expenditures by \$166.7M as at December 31, 2020. This accumulated surplus has mainly been used to fund the Airport's capital development. Further details on the Airport's annual surplus are included below within the discussion on the Airport's Statement of Operations and Accumulated Surplus.

Statement of Operations and Accumulated Surplus

The Statement of Operations and Accumulated Surplus presents the Airport's revenues, expenditures, annual surplus and accumulated surplus for the years ended December 31, 2020 and December 31, 2019. This statement provides a summary of Airport's operations during 2020 and 2019.

It is important to note that, as legislated, the budget figures used for comparison are from the final budget that was approved in the second quarter of 2020 and does not include any transfers or amendments that were subsequently made.

Annual deficit

The Airport had an annual deficit of \$1.4M for the year ended December 31, 2020 due to expenditures of \$22.0M exceeding revenues of \$20.6M. The Airport's annual surplus decreased by \$16.6M between 2019 and 2020, as revenues decreased by \$19.4M while expenditures decreased by \$2.8M. It is important to note that the annual surplus includes costs resulting from the Airport's investment in its capital infrastructure including amortization, reimbursement of costs from the Federal Government, and the actuarial increase associated with the Airport's debenture debt. Excluding these costs, the Airport's operating annual surplus is \$5.0M, as shown below.

	Year ended December 31, 2020
Annual Surplus (deficit)	(1,423,000)
Add: Amortization	7,748,000
Less: Conditional transfers (reimbursement of capital costs)	(1,149,000)
Less: Actuarial increase for debenture debt	(194,000)
	<u>4,982,000</u>

The contribution of each of the AIF, Airside, Groundside and Terminal business segments to the Airport's adjusted annual surplus is shown below. Other revenues consist of interest income, government transfers, and the actuarial increase. Other expenditures consist of administration, interest expense and policing.

	AIF	Airside	Groundside	Terminal	Other	Total
Revenue	7,351,000	2,751,000	6,162,000	2,590,000	1,677,000	20,531,000
Expenditure	(5,144,000)	(3,711,000)	(3,305,000)	(5,445,000)	(4,349,000)	(21,954,000)
<b>Annual Surplus (Deficit)</b>	<b>2,207,000</b>	<b>(960,000)</b>	<b>2,857,000</b>	<b>(2,855,000)</b>	<b>(2,672,000)</b>	<b>(1,423,000)</b>

### Revenue

The Airport's revenues consist of sale of services, interest earned, transfers from the Government, actuarial increase and gain on the disposal of tangible capital assets. Total revenues decreased by \$19.5M from \$40.0M to \$20.5M between 2019 and 2020. The COVID-19 pandemic had a significant, negative impact on the Airport's operations and resulted in a 64% decrease in passenger numbers compared to 2019. This resulted in substantial decreases in revenues, as outlined in the following:

i. Sale of services

The Airport's sale of services of \$11.5M mainly consist of vehicle parking revenues (\$3.0M), car rental fees (\$2.6M), landing fees (\$2.1M), terminal fees (\$1.5M) and lease revenues (\$1.4M). Sale of services decreased \$10.7M between the year ended December 31, 2019 and December 31, 2020 mainly due to a \$4.8M decrease in parking revenues, a 2.2M decrease in landing fees, a \$2.1M decrease in terminal fees, and a \$0.8M decrease in car rental fees.

ii. Airport improvement fees

The Airport earned \$9.3M less in airport improvement fees (AIF) during the year ended December 31, 2020 than the year ended December 31, 2019 due to a 64% decrease in enplaned passengers compared to 2019, as a result of the COVID-19 pandemic.

iii. Interest earned

The Airport earned \$0.4M less in interest during the year ended December 31, 2020 than the year ended December 31, 2019 due to the decrease of interest rates.

iv. Government transfers

The Airport's transfers from the government increased \$0.9M between the year ended December 31, 2019 and the year ended December 31, 2020 mainly due to a provincial COVID-19 relief funding grant (\$0.5M) and an increase in the Western Diversification funding grant (\$0.2M).

v. Actuarial Increase

The actuarial increase for the Airport's debenture debt increased \$0.1M between the years ended December 31, 2019 and December 31, 2020.

## Expenses

The Airport's expenses consist of administration, interest, terminal operations, AIF, policing, groundside operations, airside operations and write-down of tangible capital assets. Total expenses decreased by \$2.7M from \$24.7M to \$22.0M between the years ended December 31, 2019 and December 31, 2020. During 2020, certain measures were implemented to help reduce operating expenditures and mitigate the significant, negative impact of COVID-19 on the Airport's business. Further details on the reductions are outlined in the following:

i. Administration

Administration expenditures decreased by \$0.8M between the years ended December 31, 2019 and December 31, 2020. Administration expenditures include the Municipal Fee which increased \$0.2M from \$1.3M in 2019 to \$1.5M in 2020. The remaining administration expenditures decreased \$1.0M from \$3.1M for the year ended December 31, 2019 to \$2.1M for the year ended December 31, 2020. The decrease in administration expenditures was mainly due to a \$0.5M decrease in professional and consulting services, combined with a \$0.2M decrease in marketing and media expenditures, which were the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

ii. Terminal expenditures

Terminal expenditures consist of expenditures associated with the operation and maintenance of the Airport's terminal building. Terminal expenditures decreased \$0.9M from \$6.3M in 2019 to \$5.4M in 2020 mainly due to a decrease in maintenance costs (\$0.7M), which was the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

iii. Airport Improvement Fee expenditures

Airport Improvement Fee expenditures decreased \$0.3M from \$5.4M in 2019 to \$5.1M in 2020 due to a decrease in amortization expense (\$0.3M).

iv. Groundside expenditures

Groundside expenditures consist of the costs associated with operating and maintaining the Airport lands outside of the airside area, excluding the terminal building. Groundside expenditures decreased \$0.1M from \$3.4M in 2019 to \$3.3M in 2020 mainly due to a decrease in fuel consumption, which was the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

v. Airside expenditures

Airside expenditures consist of the costs associated with operating and maintaining the Airport lands within the fenced area including the apron, taxiways and runway, but excluding the terminal building. Airside expenditures decreased \$0.5M from \$4.2M in 2019 to \$3.7M in 2020 mainly due to decreases in salaries and wages (\$0.2M), fuel consumption (\$0.1M), facility maintenance (\$0.1M), and purchase services (\$0.1M), which were the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

When expenditures are assessed for the Airport as a whole rather than by business segment, the \$2.7M decrease from \$24.7M in 2019 to \$22.0M in 2020 is mainly due to:

i. Materials and supplies

The cost of materials and supplies decreased \$0.5M between the years ended December 31, 2019 and December 31, 2020 mainly due to a \$0.3M decrease in fuel consumption, which was the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

ii. Amortization expense

Amortization expense decreased \$0.1M from \$7.9M in 2019 to \$7.8M in 2020, mainly due to a \$0.6M decrease in amortization for assets that were fully amortized in 2020, offset by a \$0.5M increase in amortization for new additions in 2020.

iii. Salaries and benefits

Salaries and benefits decreased \$0.4M from \$4.8M to \$4.4M between the years ended December 31, 2019 and December 31, 2020, which was the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

iv. Contract and professional services

Contract and professional services decreased \$1.7M between the years ended December 31, 2019 and December 31, 2020. This is mainly due to a decrease in facility maintenance services of \$0.8M, and a \$0.6M decrease in professional and consulting services, which were the result of measures implemented to help mitigate the significant, negative impact of COVID-19.

v. Policing and other Municipal services

Policing and other Municipal services increased \$0.2M from \$1.5M in 2019 to \$1.7M in 2020, due to the increase of the Municipal Fee.

### **Statement of Changes in Net Financial Assets**

The Airport's Statement of Changes in Net Financial Assets reconciles the Airport's net financial assets at the beginning and end of the year. The Airport's net financial assets increased \$1.1M from \$14.3M at December 31, 2019 to \$15.4M at December 31, 2020 mainly due to an annual deficit after depreciation of \$1.4M combined with \$5.4M in tangible capital assets, that were more than offset by \$7.8M in depreciation.

### **Statement of Cash Flows**

The Airport's Statement of Cash Flows outlines the cash generated and used by the Airport's operations, capital activities, investing activities and financing activities. The Airport's cash and cash equivalents increased \$2.6M between December 31, 2019 and December 31, 2020 as the Airport generated \$7.3M in cash from operations, increased the long term payable by \$1.1M, reduced the amount invested in portfolio investments by \$2.4M, acquired \$5.4M of tangible capital assets, repaid debenture debt principal of \$1.9M, and repaid \$0.9M of the Shadow Ridge golf course mortgage.



## **Notes to the Airport's Financial Statements**

### **Update on the COVID-19 Pandemic**

On March 11, 2020, the World Health Organization officially declared the COVID-19 outbreak a pandemic. The pandemic has forced governments to implement extraordinary measures to slow the progress of infections and to stabilize disrupted economies and financial markets. The Airport has deployed initiatives in order to protect the health and safety of its employees and customers, support its customers, and mitigate the impact of the crisis while ensuring continuity of its operations. As a result of the aforementioned conditions, the Airport saw a significant decrease in flights, passenger volumes and revenues in 2020, and expects flights, passenger volumes and revenues to continue to be impacted well beyond 2021. As of this time, it is difficult to assess the impact of the pandemic on the Airport's future results as it is dependent on the length and severity of the pandemic and corresponding economic recovery. Management will continue to monitor and assess the situation and respond accordingly.

### **Contingent Liability**

#### Pension Liability

During the year ended December 31, 2020, the Airport paid \$0.3M for employer contributions to the Municipal Pension Plan.

### **Commitments**

At December 31, 2020, the Airport had entered into commitments of \$5.1M.

**This concludes the review of the Airport's Audited Financial Statements for the years ended December 31, 2020 and December 31, 2019.**