

# Memo



**Date:** April 28, 2022

**To:** Audit Committee

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

**Subject:** Audit Committee Review of Kelowna International Airport's December 31, 2021 Audited Financial Statements

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

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

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] shall submit within 120 days after the [City'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, 2021 and December 31, 2020.

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 \$40 million ("M") exceeded its liabilities of \$15.7M by \$24.3M at December 31, 2021. As a result, the Airport has sufficient financial assets to settle its existing liabilities as at December 31, 2021. The Airport's net financial assets increased \$8.9M from \$15.4M at December 31, 2020 to \$24.3M at December 31, 2021, mainly due to a \$4.6M increase in accounts receivable, a \$2.2M decrease in debenture debt, a \$1.3M increase in cash, and a \$0.9M decrease in mortgage payable, which were partially offset by a \$0.7M decrease in investments.

### **Financial Assets**

The Airport's financial assets have increased by approximately \$5.2M from \$34.8M at December 31, 2020 to \$40M at December 31, 2021 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 \$1.3M from \$3.7M to \$5.0M between December 31, 2020 and December 31, 2021. Further details on these movements have been included below under the discussion on the Airport's Statement of Cash Flows.

ii. Accounts receivable

The Airport's account receivables increased approximately \$4.5M from \$2.1M at December 31, 2020 to \$6.6M at December 31, 2021. This was mainly due to a \$3.2M accrual for the Regional Air Transportation Initiative grant, which was awarded in 2021 but not received until 2022. The remainder of the increase is due to revenues being higher in 2021 than in 2020 as the Airport commenced its recovery from the COVID-19 pandemic and passenger numbers increased from 737k in 2020 to 830k in 2021.

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 \$0.7M between December 31, 2020, and December 31, 2021, as portfolio investments were used to help fund expenditures.

Liabilities

The Airport's liabilities have decreased \$3.7M from \$19.4M at December 31, 2020 to \$15.7M at December 31, 2021, due to the movements outlined below:

i. Accounts payable

The Airport's accounts payable decreased \$0.5M from \$2.9M at December 31, 2020 to \$2.4M at December 31, 2021 mainly due to a \$0.4M decrease in holdbacks. The decrease in holdbacks was mainly due to fewer multi-year capital projects in 2021, in order to help reduce costs and mitigate the significant, negative impact of the COVID-19 pandemic. As a result, the capital projects requiring a holdback were completed in 2021 and the outstanding holdbacks were paid.

ii. Deferred revenue

The Airport's deferred revenue consists of cash received for services not yet provided with regards to aircrew parking, shuttle and limo licenses, advertising, annual aircraft parking and leases. The Airport's deferred revenue increased \$0.2M from \$0.2M at December 31, 2020 to \$0.4M at December 31, 2021, mainly due to overpayments received in 2021 for car rental revenues.

iii. 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, 2020, and December 31, 2021 is due to the annual payment that was made in 2021 which represents the last annual payment for this mortgage payable.

iv. Long term payable

The Airport's long term payable mainly consists of the 2021 municipal services and administration fees payable to the City of Kelowna (the Municipal Fee). Due to the significant, negative impact of the COVID-19 pandemic, \$1.0M of the \$1.5M 2020 Municipal Fee was deferred and agreed to be paid between 2021 and 2023. The \$0.4M decrease in the long term payable between December 31, 2020, and December 31, 2021, is due to the annual payment that was made in 2021. The remaining \$0.7M represents the annual payments which will be made in 2022 and 2023. This long term payable is non-interest bearing.

v. Debenture debt

The Airport's debenture debt consists of four debt issuances from the Municipal Finance Authority as outlined below. The \$2.2M decrease in debenture debt from \$14.1M at December 31, 2020 to \$11.9M at December 31, 2021 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, 2021
October 2015	10	7,500,000	4,188,000	3,312,000
April 2016	10	3,500,000	1,600,000	1,900,000
October 2016	10	3,000,000	1,389,000	1,611,000
April 2017	10	8,000,000	2,919,000	5,081,000
<b>Total</b>		<b>\$22,000,000</b>	<b>\$10,096,000</b>	<b>\$11,904,000</b>

Non-financial Assets

The Airport's non-financial assets have decreased \$1.3M from \$151.3M at December 31, 2020 to \$150M at December 31, 2021 due to the movements outlined below:

i. Prepaid expenses

The Airport's prepaid expenses increased \$0.1M from \$0.1M to \$0.2M between December 31, 2020, and December 31, 2021. This increase was mainly due to the increase in expenditures in 2021, compared to the end of 2020, as the airport entered the recovery phase of the COVID-19 pandemic in the last quarter of 2021.

ii. Inventory

The Airport's inventory consists of chemicals, fuel and supplies. Inventory increased \$0.2M from \$0.2M at December 31, 2020, to \$0.4M at December 31, 2021, mainly due to an increase in chemical purchases for winter operations in the fourth quarter of 2021 in order to mitigate supply chain issues that were anticipated subsequent to the to the atmospheric river event and closing of the Coquihalla highway in the last quarter of 2021.

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 increased \$1.3M from \$6.6M to \$7.9M between December 31, 2020, and December 31, 2021, mainly due to the addition of \$1.5M in terminal expansion design costs, which was partially offset by the transfer of \$0.3M of costs to tangible capital assets upon the completion of construction projects during the year ended December 31, 2021.

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 \$2.9M from \$144.4M at December 31, 2020, to \$141.5M at December 31, 2021, due to additions of \$4.6M (transfer from work in progress represents \$0.3M) which were offset by the recognition of \$7.5M in amortization. The \$4.6M of additions mainly consisted of the (i) taxiway Delta pavement rehabilitation project (\$3.9M), (ii) parking lot equipment replacement (\$0.4M), and a number of smaller projects.

Accumulated Surplus

The Airport's accumulated surplus increased by \$7.5M from \$166.7M at December 31, 2020 to \$174.2M at December 31, 2021. The Airport's cumulative revenues exceed its cumulative expenditures by \$174.2M as at December 31, 2021. 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, 2021, and December 31, 2020. This statement provides a summary of the Airport's operations during 2021 and 2020.

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 2021 and does not include any transfers or amendments that were subsequently approved.

Annual surplus

The Airport had an annual surplus of \$7.5M for the year ended December 31, 2021, due to revenues of \$29.5M exceeding expenditures of \$22.0M. The Airport's annual surplus increased by \$8.9M between 2020 and 2021, as revenues increased by \$9M while expenditures increased by \$0.1M. 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 annual operating surplus is \$7.5M, as shown below.

	<b>Year ended December 31, 2021</b>
Annual Surplus (deficit)	\$7,485,000
Add: Amortization	\$7,543,000
Less: Conditional transfers (reimbursement of operating costs)	(\$7,269,000)
Less: Actuarial increase for debenture debt	(\$262,000)
	<b><u>\$7,497,000</u></b>

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	\$9,483,000	\$3,113,000	\$5,926,000	\$3,256,000	\$7,752,000	\$29,530,000
Expenditure	(\$4,884,000)	(\$3,674,000)	(\$3,257,000)	(\$5,475,000)	(\$4,755,000)	(\$22,045,000)
<b>Annual Surplus (Deficit)</b>	<b>\$4,599,000</b>	<b>(\$561,000)</b>	<b>\$2,669,000</b>	<b>(\$2,219,000)</b>	<b>\$2,997,000</b>	<b>\$7,485,000</b>

### Revenue

The Airport's revenues consist of sale of services, interest earned, transfers from the Government, and actuarial increase. Total revenues increased by \$9M from \$20.5M to \$29.5M between 2020 and 2021. The COVID-19 pandemic has had a significant, negative impact on the Airport's operations in 2020 and 2021. The Airport commenced its recovery from the COVID-19 pandemic in 2021, which resulted in passenger numbers increasing 14% in 2021 when compared to 2020. This, along with substantial government grants, has resulted in an increase in revenues, as outlined below:

i. Sale of services

The Airport's sale of services of \$12.3M mainly consist of vehicle parking revenues (\$3.3M), landing fees (\$2.3M), car rental fees (\$1.9M), terminal fees (\$1.7M), lease revenues (\$1.7M), and other revenues (\$1.1M). Sale of services increased \$0.8M between the years ended December 31, 2020, and December 31, 2021, mainly due to a 0.4M increase in concession revenues, a \$0.3M increase in parking revenues, a 0.2M increase in landing fees, a \$0.2M increase in terminal fees, and a 0.2M increase in lease revenue, which were partially offset by a \$0.7M decrease in car rental fees.

ii. Airport improvement fees

The Airport earned \$2.1M more in airport improvement fees (AIF) during the year ended December 31, 2021, than the year ended December 31, 2020. This is due to a 14% increase in enplaned passengers compared to 2020 combined with an increase in the AIF from \$20 per enplaned passenger to \$25 per enplaned passenger which became effective March 1, 2020.

iii. Interest earned

The Airport earned \$0.1M less in interest during the year ended December 31, 2021, than the year ended December 31, 2020, due to the reduction of interest rates starting in the second quarter of 2020.

iv. Government transfers

The Airport's grants from the federal and provincial government increased \$6.1M between the year ended December 31, 2020, and the year ended December 31, 2021, mainly due to the receipt of the Regional Air Transportation Initiative federal grant (\$3.3M) and the Airport Relief Fund federal grant (\$3.1M).

v. Actuarial Increase

The actuarial increase for the Airport's debenture debt increased \$0.1M between the years ended December 31, 2020, and December 31, 2021.

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 remained consistent at \$22.0M between the years ended December 31, 2020, and December 31, 2021. During 2020 and 2021, certain measures were implemented to help reduce operating expenditures and mitigate the significant, negative impact the COVID-19 pandemic had on the Airport's business. Further details are outlined in the following:

i. Administration

Administration expenditures increased by \$0.4M between the years ended December 31, 2020, and December 31, 2021. Administration expenditures include the Municipal Fee which increased \$0.1M from \$1.5M in 2020 to \$1.6M in 2021. The remaining administration expenditures increased \$0.3M from \$2.1M for the year ended December 31, 2020, to \$2.4M for the year ended December 31, 2021. The increase in administration expenditures was mainly due to a \$0.2M increase in professional and consulting services largely attributed to services required for federal grant applications.

ii. Terminal expenditures

Terminal expenditures consist of expenditures associated with the operation and maintenance of the Airport's terminal building. Terminal expenditures remained consistent between 2020 and 2021. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021 and resulted in similar spending for the operation and maintenance of the terminal compared to 2020.

iii. Airport Improvement Fee expenditures

Airport Improvement Fee expenditures decreased \$0.2M from \$5.1M in 2020 to \$4.9M in 2021 due to a decrease in amortization expense (\$0.2M).

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 remained consistent between 2020 and 2021. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021 and resulted in similar spending for the operation and maintenance of the Airport groundside lands, compared to 2020.

v. Airside expenditures

Airside expenditures consist of the costs associated with operating and maintaining the Airport lands within the security perimeter including the apron, taxiways and runway, but excluding the terminal building. Airside expenditures remained consistent at \$3.3M between 2020 and 2021. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021 and resulted in similar spending for the operation and maintenance of the Airport airside lands compared to 2020.

When expenditures are assessed for the Airport as a whole rather than by business segment, expenditures by type remained consistent between 2020 and 2021, as outlined below:

i. Materials and supplies

The cost of materials and supplies decreased \$0.1M between the years ended December 31, 2020, and December 31, 2021. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021 and resulted in similar spending for materials and supplies compared to 2020.

ii. Amortization expense

Amortization expense decreased \$0.2M from \$7.7M in 2020 to \$7.5M in 2021, mainly due to a \$0.6M decrease in amortization for assets that were fully amortized in 2021, offset by a \$0.4M increase in amortization for new additions in 2021.

iii. Salaries and benefits

Salaries and benefits increased \$0.1M from \$4.4M to \$4.5M between the years ended December 31, 2020, and December 31, 2021. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021 and resulted in similar spending for salaries and benefits compared to 2020.

iv. Contract and professional services

Contract and professional services increased \$0.2M between the years ended December 31, 2020, and December 31, 2021, mainly due to services obtained to help apply for federal grant applications.

v. Policing and other Municipal services

Policing and other Municipal services increased \$0.1M from \$1.7M in 2020 to \$1.8M in 2021, due to an increase in 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 \$8.9M from \$15.4M at December 31, 2020 to \$24.3M at December 31, 2021. This is mainly attributed to an annual surplus after depreciation of \$7.5M combined with depreciation of \$7.5M, which was partially offset by the acquisition of \$5.9M of tangible capital assets.

## **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 \$1.3M between December 31, 2020, and December 31, 2021, as the Airport generated \$9.7M in cash from operations, changed \$0.7M in portfolio investments to cash, acquired \$5.9M of tangible capital assets, repaid debenture debt principal of \$1.9M, repaid \$0.9M of the mortgage payable, and repaid \$0.4M of the long term payable.

## **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 2021, and expects flights, passenger volumes and revenues to continue to be impacted well beyond 2022. 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, 2021, the Airport paid \$0.3M for employer contributions to the Municipal Pension Plan.

### *Commitments*

At December 31, 2021, the Airport had entered into commitments of \$0.3M.

**This concludes the review of the Airport's Audited Financial Statements for the years ended December 31, 2021, and December 31, 2020.**