

# Memo



**Date:** April 25, 2023

**To:** Audit Committee

**From:** Joe Sass, Finance Director, Financial Services

**Subject:** Audit Committee Review of Kelowna International Airport's December 31, 2022 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 aggregate 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, 2022 and December 31, 2021.

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, 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 \$55.2 million ("M") exceeded its liabilities of \$17.5M by \$37.7M at December 31, 2022. As a result, the Airport has sufficient financial assets to settle its existing liabilities as at December 31, 2022. The Airport's net financial assets increased \$13.4M from \$24.3M at December 31, 2021 to \$37.7M at December 31, 2022, mainly due to a \$10.1M increase in portfolio investments, a \$4.8M increase in accounts receivable, and a \$2.2M decrease in debenture debt, which were partially offset by a \$3.5M increase in accounts payable.

### **Financial Assets**

The Airport's financial assets have increased by approximately \$15.2M from \$40M at December 31, 2021 to \$55.2M at December 31, 2022 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 \$0.2M from \$5.0M to \$5.2M between December 31, 2021 and December 31, 2022. Further details on these movements are included under the discussion on the Airport's Statement of Cash Flows.

ii. Accounts receivable

The Airport's account receivables increased approximately \$4.8M from \$6.6M at December 31, 2022 to \$11.4M at December 31, 2022. This was mainly due to a \$6.4M accrual for Airport Critical Infrastructure Program grants, which were awarded and earned in 2022 but not received until 2023. This increase was partially offset by a one-time accrual that was made in 2021 for the \$3.3M Regional Air Transportation Initiative grant that the Airport earned. The remainder of the increase is mainly due to revenues being higher in 2022 than in 2021 as the Airport continued its recovery from the COVID-19 pandemic and passenger numbers increased from 830k in 2021 to 1.7M in 2022.

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 increased by \$10.1M between December 31, 2021, and December 31, 2022.

Liabilities

The Airport's liabilities have increased \$1.8M from \$15.7M at December 31, 2021 to \$17.5M at December 31, 2022, due to the movements outlined below:

i. Accounts payable

The Airport's accounts payable increased \$3.5M from \$2.4M at December 31, 2021 to \$5.9M at December 31, 2022 mainly due to a \$1.4M increase in holdbacks and \$1.8M in trade accounts payable. The increase in holdbacks and payables was due to more multi-year capital projects in 2022, as projects deferred during the COVID-19 pandemic have now commenced

ii. Performance Deposits

The Airport's performance deposits increased by \$0.7M from \$0.2M at December 31, 2021 to \$0.9M at December 31, 2022. This is mainly due to a \$0.5M deposit received for a new sublease for the hotel negotiated during 2022, and an airline security deposit of \$0.1M received from a new airline.

iii. Deferred revenue

The Airport's deferred revenue consists of cash received for services not yet provided with regards to grants, aircrew parking, shuttle and limo licenses, advertising, annual aircraft parking and leases. The Airport's deferred revenue increased \$0.1M from \$0.4 at December 31, 2021 to \$0.5M at December 31, 2022, mainly due to \$0.4M of grant funding received in advance for the Child Care Facility, which was partially offset as car rental revenues were overpaid in 2021 but were not overpaid in 2022.

iv. Long term payable

The Airport's 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 the COVID-19 pandemic, \$1.0M of the \$1.5M 2020 Municipal Fee was deferred with payment to be made between 2021 and 2023. The \$0.4M decrease in the long-term payable between December 31, 2021, and December 31, 2022, is due to the annual payment made in 2021. The remaining \$0.4M payable represents the annual payment which will be made in 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 \$11.9M at December 31, 2021 to \$9.7M at December 31, 2022 was due to the repayment of principal associated with the debenture debt issued between 2015 and 2017.

Date of Issue	Term (Years)	Amount of Issue	Sinking Fund Balance	Net Debt at December 31, 2022
October 2015	10	7,500,000	4,973,000	2,527,000
April 2016	10	3,500,000	1,954,000	1,546,000
October 2016	10	3,000,000	1,693,000	1,307,000
April 2017	10	8,000,000	3,705,000	4,295,000
<b>Total</b>		<b>\$22,000,000</b>	<b>\$12,325,000</b>	<b>\$9,675,000</b>

Non-financial Assets

The Airport's non-financial assets have increased \$11.3M from \$150.0M at December 31, 2021 to \$161.3M at December 31, 2022 due to the movements outlined below:

i. Prepaid expenses

The Airport's prepaid expenses have remained at \$0.2M between December 31, 2021, and December 31, 2022.

ii. Inventory

The Airport's inventory consists of chemicals, fuel, and supplies. Inventory remained consistent between December 31, 2021, and December 31, 2022.

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 \$5.2M from \$7.9M to \$13.1M between December 31, 2021, and December 31, 2022, as many projects deferred due to the impacts from COVID-19 commenced during the year. Notable projects that were in progress at December 31, 2022 include the Airport Terminal Building Expansion (\$10.9M) and construction for the Child Care Facility (\$1.3M).

iv. Tangible capital assets

Tangible capital assets consist of land, land improvements, buildings, infrastructure, and machinery and equipment. The Airport's tangible capital assets increased \$6.2M from \$141.5M at December 31, 2021, to \$147.7M at December 31, 2022, due to additions of \$14.4M (transfer from work in progress represents \$0.3M), offset by the recognition of \$8.2M in amortization. The additions in 2022 included the Runway End Safety Area project (\$6.8M), Biosecurity Testing Facility (\$5.4M), and the roof replacement project (\$1.1M), all of which received grant through the Airport Critical Infrastructure Program.

### Accumulated Surplus

The Airport's accumulated surplus increased by \$24.8M from \$174.2M at December 31, 2021 to \$199.0M at December 31, 2022. The Airport's cumulative revenues exceed its cumulative expenditures by \$199.0M as at December 31, 2022. This accumulated surplus has 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, 2022, and December 31, 2021. This statement provides a summary of the Airport's operations during 2022 and 2021.

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 2022 and does not include any transfers or amendments that were subsequently approved.

### Annual surplus

The Airport had an annual surplus of \$24.8M for the year ended December 31, 2022, due to revenues of \$51.2M exceeding expenditures of \$26.4M. The Airport's annual surplus increased by \$17.3M between 2021 and 2022, as revenues increased by \$21.7M while expenditures increased by \$4.4M. 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 \$24.8M, as shown below.

	<b>Year ended December 31, 2022</b>
Annual surplus	\$ 24,801,000
Add: amortization	8,161,000
Less: conditional transfers (reimbursement of capital expenditures)	(7,784,000)
Less: actuarial increase for debenture debt	(332,000)
	<b>\$ 24,846,000</b>

### Revenue

The Airport's revenues consist of sale of services, interest earned, transfers from the Government, and the actuarial increase. Total revenues increased by \$21.7M from \$29.5M to \$51.2M between 2021 and 2022. The COVID-19 pandemic had a significant, negative impact on the Airport's operations in 2020 and 2021, with recovery beginning in 2021 and continuing into 2022. As a result, passenger numbers increased from 830k in 2021 to 1.7M in 2022. 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 \$22.6M consist of vehicle parking revenues (\$8.2M), landing fees (\$3.8M), car rental fees (\$3.3M), terminal fees (\$3.0M), lease revenues (\$2.1M), other revenues

(\$1.6M), and terminal concessions (\$0.7M). Sale of services increased \$10.3M between the years ended December 31, 2021, and December 31, 2022, mainly due to a \$4.8M increase in parking revenues, a \$1.6M increase in car rental revenues, a \$1.5M increase in landing fees, and a \$1.3M increase in terminal fees.

ii. Interest earned

The Airport earned an additional \$0.8M of interest during the year ended December 31, 2022, compared to the year ended December 31, 2021, due to rising interest rates during the year.

iii. Government transfers

The Airport's grants from the federal and provincial government increased \$0.5M between the year ended December 31, 2021, and the year ended December 31, 2022, mainly due to the receipt of the Federal Airport Critical Infrastructure Program grants (\$6.5M), and Provincial Child Care Capital Funding Program (\$1.1M) grant received in 2022. This was partially offset by \$7.1M of one-time Federal and Provincial COVID-19 relief grants that were earned in 2021.

iv. Actuarial Increase

The actuarial increase for the Airport's debenture debt increased \$0.1M between the years ended December 31, 2022, and December 31, 2021.

v. Airport improvement fees

The Airport earned \$9.9M more in airport improvement fees (AIF) during the year ended December 31, 2022, than the year ended December 31, 2021. This is due to a 104% increase in enplaned passengers in 2022 when compared to 2021 as travel restrictions eased.

### Expenses

The Airport's expenses consist of administration, interest, terminal operations, AIF, policing, groundside operations, airside operations and the write-down of tangible capital assets. Total expenses increased by \$4.4M from \$22.0M to \$26.4M between the years ended December 31, 2021, and December 31, 2022. 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. With recovery beginning in 2021 and continuing in 2022, the Airport started to return to normal operations and corresponding costs. Further details are outlined in the following:

i. Administration

Administration expenditures increased by \$0.2M between the years ended December 31, 2021, and December 31, 2022. Administration expenditures include the Municipal Fee which decreased \$0.4M from \$1.6M in 2021 to \$1.2M in 2022. The remaining administration expenditures increased \$0.6M from \$2.4M for the year ended December 31, 2021, to \$3.0 M for the year ended December 31, 2022. The increase in administration expenditures was due to an increase in wages and salaries of \$0.3M, and an increase in administrative recoveries of \$0.2M relating to contributions received for the YLW 75<sup>th</sup> Anniversary events in 2022.

ii. Terminal expenditures

Terminal expenditures consist of expenditures associated with the operation and maintenance of the Airport's terminal building. Terminal expenditures increased by \$0.8M between 2021 and 2022 from \$5.5M to \$6.3M. This is due to increased operations as post-pandemic recovery continued in 2022 and operational costs increased as a result of resuming full operations, including facility maintenance returning to full contract service levels (\$0.6M increase in 2022).

iii. Airport Improvement Fee expenditures

iv. Airport Improvement Fee expenditures increased \$0.6M from \$4.9M in 2021 to \$5.5M in 2022 due to an increase in amortization expense (\$0.6M) resulting from the completion of projects in 2022 including the biosecurity facility, runway end safety area construction, terminal building improvements, airside pavement rehabilitation, and passenger loading bridge upgrades and refurbishment.

v. 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 increased by \$1.5M between 2021 and 2022 from \$3.3M to \$4.8M. The increase is mainly due to the change in the parking management contract that resulted in the Airport earning all of the revenues and paying for all of the expenditures (\$1.0M) in 2022, rather than earning a percentage of gross revenues and incurring no expenditures.

vi. 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 increased by \$1.0M from \$3.7M in 2021 to \$4.7M in 2022. The increase is mainly due to increased operations as post-pandemic recovery continued in 2022 and operational costs increased as a result of resuming full operations. Wages and salaries for airside operations increased \$0.5M in the year, from \$1.1M in 2021 to \$1.6M in 2022.

When expenditures are assessed for the Airport rather than by business segment, expenditures by type increased between 2021 and 2022, as outlined below:

i. Amortization expense

Amortization expense increased \$0.7M from \$7.5M in 2021 to \$8.2M in 2022, due to asset additions of \$14.4M during 2022.

ii. Contract and professional services

Contract and professional services increased \$2.0M between the years ended December 31, 2021, and December 31, 2022 from \$5.3M to \$7.3M, mainly due to contracted services returning to full levels in order to support regular operating levels as the Airport continued to recover from the COVID-19 pandemic.

iii. Salaries and benefits

Salaries and benefits increased \$1.2M from \$4.5M to \$5.7M between the years ended December 31, 2021, and December 31, 2022. Measures implemented in 2020 to help mitigate the significant, negative impact of the COVID-19 pandemic were in effect for the majority of 2021. With post-pandemic recovery continuing in 2022, the Airport returned to full operations that resulted in hiring and an increase in salaries and benefits.

iv. Materials and supplies

The cost of materials and supplies increased \$0.9M between the years ended December 31, 2021, and December 31, 2022, mainly due to the continued recovery from the COVID-19 impact with a return to full operations, combined with significant inflation experienced during 2022.

v. Policing and other Municipal services

Policing and other Municipal services decreased \$0.4M from \$1.8M in 2021 to \$1.4M in 2022, due to a decrease in the fees for Municipal services.

### **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 \$13.4M from \$24.3M at December 31, 2021 to \$37.7M at December 31, 2022. This is attributed to an annual surplus after depreciation of \$24.8M combined with depreciation of \$8.2M, which was partially offset by the acquisition of \$19.6M 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 \$0.2M between December 31, 2021, and December 31, 2022, as the Airport generated \$32.2M in cash from operations, changed \$10.1M in cash to portfolio investments, acquired \$19.6M of tangible capital assets, repaid debenture debt principal of \$1.9M, 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 forced governments to implement extraordinary measures to slow the progress of infections and to stabilize disrupted economies and financial markets. The Airport 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, 2021 and 2022. Recovery commenced in 2022, but the Airport expects flights, passenger volumes and revenues to continue to be impacted beyond 2022 and, as of this time, it is difficult to assess the length or severity of the impact 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, 2022, the Airport paid \$0.4M for employer contributions to the Municipal Pension Plan.

Commitments

At December 31, 2022, the Airport had entered into commitments of \$6.6M.

**This concludes the review of the Airport's Audited Financial Statements for the years ended December 31, 2022, and December 31, 2021.**