

**CITY OF HAMILTON
 INTERNAL AUDIT REPORT 2014-04
 CORPORATE SERVICES – LONG TERM DEBT**

#	OBSERVATIONS OF EXISTING SYSTEM	RECOMMENDATION FOR STRENGTHENING SYSTEM	MANAGEMENT ACTION PLAN
1.	<p><u>Policies and Procedures</u></p> <p>There are two procedures that relate to long term debt. The procedure for "Payment of Various Debentures" was developed in June of 2012 and the "Debt Issuance" procedure is over three years old. Neither procedure has been reviewed since development despite the City having a new Debt Management Policy as of October 2013. Procedures have not been developed to provide instruction in other relevant aspects of long term debt: debt retirement and the maintenance of debt records.</p> <p>The workflows related to long term debt impact staff in the Capital Budgets, Corporate Reporting and Investments Sections. Procedures have not been developed for staff in the Capital Budgets and Corporate Reporting Sections.</p> <p>When formal procedures are lacking, employees use personal understanding and experience to carry out processes which could result in incorrect, incomplete or inconsistent application. It would also be problematic and inefficient for a successor to commence his/her duties within a short period of time.</p>	<p>That formal procedures (where they do not exist) be developed, implemented and approved by management. The procedures should be reviewed annually by management, updated as required and bear evidence of such review (i.e. sign-off). The procedures must address all workflows related to long term debt (including Capital Budgets, Corporate Reporting and Investments).</p>	<p>Agreed. Capital Budgets and Development Finance Budget Section of the Financial Planning & Policy Division will develop procedures for financing of the capital budget from various sources including debt, updating debt projections, updating financial ratios and issuing reports and by-laws authorizing new debt. Investments Section of the Financial Planning & Policy Division will develop procedures for the placement and issuance of debt instruments and finalizing of the debenture through Council, receipt of funds and payment of funds. Accounting Services Section of Financial Services Division will develop procedures for the maintenance of debt records, financial reporting, payments and debt retirements. Debt related procedures will be developed, implemented and approved by December 31, 2015.</p>

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2.	<p><u>Financial Measures</u></p> <p>The City's Debt Management Policy (DMP) has identified a number of ratios that provide information about the City's financial flexibility and sustainability. These include the following:</p> <ul style="list-style-type: none"> • Total tax and rate supported debt as a percentage of City Own-source Revenues (cannot exceed 60%); • Total Development Charge (DC) supported debt as a percentage of the total DC Eligible Costs for the forecast period of the latest DC Background Study (cannot exceed 25%); • The annual debt and financial obligation limit for the City (also known as the Annual Repayment Limit or ARL); and • Outstanding variable interest rate bank loan agreements and variable interest rate debentures not to exceed 15% of the total outstanding debt of the City. <p>While the above ratios are reported to Council as part of the annual Capital Budget presentation, other financial measures identified by the City's DMP are not reported. These include: debt service charges per capita; debt service charges as a percent of the municipal levy; debt to reserves and reserve funds; cash and liquid assets minus debt; and the annual increase in debt in relation to population, assessment growth, operating revenue, and average household income.</p>	<p>That management report to Council annually on the financial measures listed in the City's Debt Management Policy (this could be included as part of the annual comprehensive debt report, see recommendation #3 below).</p>	<p>Alternative to be Implemented. Committee and Council are provided with the City's debt information including financial measures during the annual budget process. A separate debt management report is not required. The financial measures which are reported in Capital Budget can be supplemented by the inclusion of the financial measures which are currently not reported but are included in the City's Debt Management Policy.</p>

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3.	<p><u>Long Term Debt and Financial Sustainability Reporting</u></p> <p>Management reports to Council at least once a year regarding projected long term debt and financial sustainability as part of the Capital Budget process. Management also submits reports to Council that describe changes to long term debt projections and financial sustainability when authorization to issue new debt is requested.</p> <p>The 2014 Capital Budget projects that the City's total outstanding debt will peak at \$897 million in 2017. This is a threefold increase from the 2013 outstanding debt of \$294 million.</p> <p>The amount of long term debt issued by the City justifies the need for a comprehensive annual report to Council that provides information about current and projected debt levels and associated servicing costs, along with reporting on any changes to the City's long term financial sustainability.</p>	<p>That management issue a comprehensive annual debt report to Council that includes information about current and projected debt levels and any impact of the debt on the City's long term financial sustainability.</p>	<p>Disagreed. A separate debt management report is not required. Committee and Council are provided with the City's debt information during the annual budget process and when a report authorizing a debenture issue is required. Debt information includes current debt levels, projected debt levels and debt charges, annual repayment limits, debt ratios and comparisons with other municipalities.</p>