



**CITY OF HAMILTON**  
**CITY MANAGER'S OFFICE**  
**Audit Services Division**

<b>TO:</b>	Chair and Members Audit, Finance and Administration Committee
<b>COMMITTEE DATE:</b>	May 8, 2017
<b>SUBJECT/REPORT NO:</b>	Performance Audit Report 2017-01 – Reserves (AUD17011) (City Wide)
<b>WARD(S) AFFECTED:</b>	City Wide
<b>PREPARED BY:</b>	Charles Brown CPA, CA, CPA (Illinois) 905-546-2424 x4469
<b>SUBMITTED BY:</b>	Charles Brown CPA, CA, CPA (Illinois) Director, Audit Services City Manager's Office
<b>SIGNATURE:</b>	

**RECOMMENDATION**

- (a) That the Management Action Plans as detailed in Appendix "A" of Report AUD17011 be approved; and
- (b) That the General Manager of Finance and Corporate Services be directed to instruct the appropriate staff to have the Management Action Plans (attached as Appendix "A" to Report AUD17011) implemented.

**EXECUTIVE SUMMARY**

Reserves are a financial tool used by municipalities to respond to uneven revenues and expenditures, and support financial flexibility. Good financial management includes a planned utilization of reserves. The 2015 Reserves Report reflected \$924.7 million in reserves, of which \$660.8 million are discretionary reserves mandated by Council.

The 2016-2018 Audit Services Work Plan approved by Council included a Value for Money Audit of Reserves. The audit focused on management practices in relation to reserve activity for the year ended December 31, 2015, and considered trend analysis for five years from 2011 to 2015.

Effectiveness and efficiency of the reserves activity, as well as sustainability and sufficiency of reserve balances was investigated. Compliance with corporate policies and accounting standards (PSAB) was assessed. Strategic direction was reviewed for alignment with Corporate objectives. Reporting of reserve activity was evaluated for understandability and transparency.

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*OUR Vision: To be the best place to raise a child and age successfully.*

*OUR Mission: To provide high quality cost conscious public services that contribute to a healthy, safe and prosperous community, in a sustainable manner.*

*OUR Culture: Collective Ownership, Steadfast Integrity, Courageous Change, Sensational Service, Engaged Empowered Employees.*

The results of the audit, including observations, recommendations, and management responses are presented in a formal Audit Report (2017-01). Audit Report 2017-01 is attached as Appendix “A” to Report AUD17011.

***Alternatives for Consideration – Not applicable***

**FINANCIAL – STAFFING – LEGAL IMPLICATIONS**

Financial: Development of corporate reserve strategy will support appropriate utilization of reserves for corporate purposes. Formulation of the reserve strategy and funding requirements can better inform decision making around multi-year budgets, so that mill rate support is appropriate over the short and mid-term.

Staffing: In the mid-term, more efficient use of reserves and reporting may result in additional capacity in the Financial Planning and Policy Department.

Legal: None.

**HISTORICAL BACKGROUND**

This audit was scheduled as part of the 2016 -2018 Audit Services Work-Plan approved by Council. The audit fieldwork was completed in March 2017. The results of this audit are attached as Appendix “A” of Report AUD17011.

The Audit, Finance and Administration Committee receives and approves performance audit reports as part of its responsibilities for oversight of governance.

**POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS**

Policy No. ADM-01 – Reserves Policy – Administration of Financial Reserves and Reserves funds

Policy No GEN-01 Reserves Policy - General Policies

**RELEVANT CONSULTATION**

Appendix “A” to Report AUD17011 includes action plans which reflect the responses of management responsible for the oversight of reserves and generation of the Annual Reserves Report, within the Financial Planning & Policy Division of the Corporate Services Department.

## **ANALYSIS AND RATIONALE FOR RECOMMENDATION**

Reserves are a financial tool used by municipalities to respond to uneven revenues and expenditures, and provide financial flexibility. The 2015 Reserves Report provides detailed information on 154 reserves with a combined balance of \$924.7 million. These reserves include 147 discretionary reserves mandated by Council with a combined balance of \$660.8 million.

While Hamilton reserve balances on a per capita basis were the second highest in the seven Canadian Municipalities reviewed, the number of the reserves and the lack of strategy made it difficult to assess the sufficiency of reserves. As well as overall strategy, a reserves and funding strategy related to underfunded employee benefit liabilities would also address risk in this area.

Effectiveness and efficiency of the reserves activity, as well as sustainability and sufficiency of reserve balances was investigated. Compliance with Corporate Policies and Accounting Standards (PSAB) was assessed. Strategic direction was reviewed for alignment with Corporate objectives. Reporting of reserve activity was evaluated for understandability and transparency.

A formal Performance Audit Report (2017-01) containing background information, audit objectives, scope, methodology, findings and recommendations was issued. Thirteen recommendations were included in the Audit Report (attached as Appendix “A” to Report AUD17-011). Some of the recommendations made are as follows:

- Develop a reserve strategy in conjunction with longer term financial plans including the capital management plan.
- Fund employee benefit liabilities in accordance with an approved funding strategy and related applicable reserves strategy, giving consideration to the impact on fiscal responsibility and intergenerational equity.
- Rationalize existing reserves, with the goal of building and retaining reserves with significant ongoing funding sources, a defined corporate purpose and larger value transactions. The goal of the reduction in total reserves should be to increase the effectiveness and efficiency of reserve and administrative activity.
- Develop umbrella policies aligned with Corporate Reserve Strategy that include required documentation on the terms and conditions of a reserve prior to approval of the new reserve.

- Develop targets for key reserve areas, such as Stabilization, Vehicle Replacement and Employee Benefits. Plans to achieve and maintain targets should be approved by Council and then financial requirements included within annual operating budgets.
- Investigate alternative formats for reserve reporting, including tabular formats for their value to external users and ease of preparation.
- Develop an ongoing review plan for all active reserves to ensure that they are reviewed within a reasonable timeframe, based on established criteria.

Management agreed with all of the recommendations. Specific action plans can be found in the audit report attached as Appendix “A” to report AUD17011.

Audit Services conducted this audit in conformity with the *International Standards for the Professional Practice of Internal Auditing*. These standards require that Audit Services plan and perform the review to obtain sufficient, appropriate evidence to support the findings and conclusions based on the review objectives. Audit Services believes that the work performed provides a reasonable basis for the review comments and conclusions.

#### **ALTERNATIVES FOR CONSIDERATION**

Not applicable.

#### **ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN**

##### **Our People and Performance**

*Hamiltonians have a high level of trust and confidence in their City government.*

#### **APPENDICES AND SCHEDULES ATTACHED**

Appendix “A” to Report AUD17011

Appendix “B” to Report AUD17011

Appendix “C” to Report AUD17011

Appendix “D” to Report AUD17011

Appendix “E” to Report AUD17011

Appendix “F” to Report AUD17011