



Hamilton

CITY OF HAMILTON
HAMILTON POLICE SERVICES BOARD

TO:	Mayor and Members General Issues Committee
COMMITTEE DATE:	July 10, 2017
SUBJECT/REPORT NO:	17-080 Performance Audit – Police Reserves (PSB 17-080; see also City Audit, Finance and Administration Committee Report AUD 17011)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Lois Morin, Hamilton Police Services Board
SUBMITTED BY:	Lois Morin
SIGNATURE:	

RECOMMENDATION

- (a) That the closure of the Provision for Police Litigation Reserve Account #112210 and the Police Special Events Reserve Account #112220, be approved; and,
- (b) That the transfer of the December 31, 2016 year ending balances of \$259,851 from the Provision for Police Litigation Reserve Account #112210; and, \$113,487 from the Police Special Events Reserve Account #112220, to the Police Tax Stabilization Reserve Account #104055, be approved.

EXECUTIVE SUMMARY

The Police Services Board met on Friday, June 16, 2017, and respectfully submits the above recommendation, which, the Police Board approved.

Alternatives for Consideration – Not Applicable.

FINANCIAL – STAFFING – LEGAL IMPLICATIONS (for recommendation(s) only)

Financial: (see attached report PSB 17-080)

Staffing: n/a

Legal: n/a

SUBJECT: Performance Audit – Police Reserves (City Wide) (PSB 17-080)

HISTORICAL BACKGROUND (Chronology of events)

(see attached report PSB 17-080)

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

(see attached report PSB 17-080)

RELEVANT CONSULTATION

(see attached report PSB 17-080)

**ANALYSIS AND RATIONAL FOR RECOMMENDATION
(Include Performance Measurement/Benchmarking Data if applicable)**

(see attached report PSB 17-080)

**ALTERNATIVES FOR CONSIDERATION
(Include Financial, Staffing, Legal and Policy Implications and Pros and Cons for each alternative)**

(see attached report PSB 17-080)

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN

(see attached report PSB 17-080)

APPENDICES

Appendix A - PSB 17-080 – **Performance Audit – Police Reserves**

cc Chief Eric Girt, Hamilton Police Service
John Randazzo, Manager, Finance, Hamilton Police Service

HAMILTON POLICE SERVICES BOARD

- RECOMMENDATION -

DATE: 2017 June 16
REPORT TO: Chair and Members
Hamilton Police Services Board
FROM: Eric Girt
Chief of Police
SUBJECT: *Performance Audit – Police Reserves
(PSB 17-080, also See City Audit, Finance and Administration
Committee Report AUD 17011)*

RECOMMENDATION:

That the Hamilton Police Service Board approve closure of the Provision for Police Litigation Reserve 112210 and the Police Special Events Reserve 112220 and transfer the December 31, 2016 ending balances of \$259,851 (\$254,733 – 2015) and \$113,487 (\$111,252 – 2015) respectively to the Police Tax Stabilization Reserve 104055.

That the Hamilton Police Service Board approve maintaining the Police Vacation Liability Reserve 112029 as a separate Reserve.

That the Hamilton Police Service Board direct the Board Administrator to refer the Board motion together with this report for execution of the motion to the City of Hamilton.



Eric Girt
Chief of Police

FINANCIAL / STAFFING / LEGAL IMPLICATIONS:

FINANCIAL – Consolidate the Provision for Police Litigation Reserve and the Police Special Events Reserve into the Police Tax Stabilization Reserve 104055, resulting in a new balance of \$864,093 as at December 31, 2016.

STAFFING – n/a

LEGAL – n/a

BACKGROUND:

Reserves are used to accumulate funds over time to replace capital assets and provide a measure of financial flexibility of budget shortfalls, unexpected/unanticipated events or relieve tax levy for any particular budget year. A balanced approach to the planning and use of reserves is considered good financial management as it permits Police funds to be spent sensibly on future Police operations, it ensures Police service levels are maintained and not immediately impacted by any potential unexpected events. Hamilton Police allotted reserves consists of eleven reserves (Appendix A). These Reserves are included in the City of Hamilton's Reserves - Detail Report issued annually.

The City of Hamilton's Department of Audit Services conducted a Value for Money Audit of City-wide Reserves including the Hamilton Police Reserves.

As stated in City's Audit, Finance and Administration Committee (AF&A) report AUD17011, "the audit focused on management practices in relation to reserve activity for the year-ended December 31, 2015 and reviewed trend analysis for the five years 2011-2015".

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

City of Hamilton Auditor, Ms. Anne Tourigny, CPA, CA, visited Hamilton Police and met with the members of the Finance unit. Each Police Reserve was examined and discussed and was provided with the HPS Reserve Continuity Report (Appendix A) for the years audited. All transfers to/from reserves were explained for the years examined. In addition, a copy of the Operating Budget Surplus/Deficit Policy approved by the Board (PSB 15-059) was provided.

Audit Findings

As per AF&A report AUD17011, audit findings relating to Hamilton Police allocated Reserves identified three (3) reserves with insignificant activity from 2011-2015. They are:

Reserve Number	Reserve Name	2015 Ending Balance	2016 Ending Balance
112029	Provision for Police Vacation Liability	\$1,438,035	\$1,466,930
112210	Provision for Police Litigation	\$254,733	\$259,851
112220	Police Special Events	\$111,252	\$113,487

Other than interest earned, there has not been any other activities due to the overall budgetary surpluses HPS realized over the last several years.

Another audit finding related to HPS states the Police Operating Budget Surplus/Deficit Policy does not provide a "Target Balance". This statement is incorrect. Appendix B of HPS 15-059 clearly identifies a target balance of \$7M. As stated earlier, a copy of the approved policy was provided during the audit.

Audit Recommendations

The only recommendation relating to Hamilton Police allocated Reserves is the request to close those reserves identified above and transfer funds to the Police Tax Stabilization Reserve due to the infrequent use of funds.

Command Response to Audit Findings/Recommendations

112029 – Police Vacation Liability Reserve

The purpose of this reserve is to finance potential vacation payouts over budgeted amounts owed to employees upon cessation of employment from the Service. It should be noted that vacation taken in the current year is the vacation owed to the employee from the previous year. Therefore, a liability exists for the vacation owed to the employee for the current year. This liability varies each year subject to: 1) the number of members who retire/resign, 2) their vacation entitlement under the Collective Agreements, when the cessation occurs during the year, and 3) if any vacation time was taken prior to their cessation date.

This reserve was established in 2005 and the source of funding is contributions from Operating Budget via approved budgeted allocation and/or annual operating budget surplus through Board Resolution. Other than interest earned, there has been no activity since 2006.

Command Recommendation – Maintain the current Reserve

Each year HPS faces numerous retirements and/or resignations. The potential exists for the transfer of funds from this Reserve to offset any possible over-expenditure in budgeted vacation pay-outs each year. Though the need has not existed for the last several years due to operating budget surplus, the exposure exists and, therefore, it is recommended to maintain the reserve for its intended use.

112210 – Police Vacation Liability Reserve

The purpose of this reserve is to cover potential unbudgeted legal expenses incurred by HPS.

The Reserve was established in 1986 and was funded through contributions from Operating fund via approved budgeted allocation and/or annual operating budget surplus through Board resolution.

Command Recommendation – Close to Police Tax Stabilization Reserve

Other than interest earned each year, there has not been any activity in this Reserve since 2002. Therefore, we are in agreement to close this Reserve and transfer the funds to the Police Tax Stabilization Reserve. Any future legal expenditure beyond the annual budgeted amounts may be funded through the Police Tax Stabilization Reserve upon Board resolution.

112220 – Police Special Events

The purpose of this Reserve is to set aside funds for use by the Hamilton Police Service Board at its discretion.

This Reserve was established in 1978 from proceeds from the sale of unclaimed property. It has the same functionality as the Auction account.

In 2000, Hamilton Police held the Canadian Association of Chiefs of Police conference and the net proceeds and expenditures were recorded in this Reserve. In addition, in 2009 through Board resolution (PSB 09-041) funds were allocated for sponsorship of the FBINAA Conference held in Hamilton. Other than interest earned each year, there has not been activity since then.

Command Recommendation – Close to Police Tax Stabilization Reserve

As there has been no activity since 2009, we are in agreement to close this Reserve and transfer funds to the Police Tax Stabilization Reserve.

Conclusion

Based on findings and recommendations of the Performance Audit Report, AUD17011, we are in agreement for the closure of the Provision for Police Litigation Reserve and the Police Special Events Reserve while maintaining the Police Provision for Vacation Liability Reserve separately as intended for its use.

EG: J. Randazzo

Attachments: *Appendix A – Summary of Reserve Balances*

Appendix B – City of Hamilton, Audit, Finance and Administration - (AUD 17011)

cc John Randazzo, Chief Accountant, Finance

Hamilton Police Service Summary of Reserve Balances 2016 Reserve Activity

Appendix A

Reserve Number	Reserve Name	Balance Dec 31/2015	Transfers To(+)	Interest Earned(+)	Transfers From (-)	Balance Dec 31/2016
104055	Tax Stabilization - Police	4,050,315	76,986	44,402	(1) 3,680,948	490,755
104056	Police ISD Forensic Building	2,137,136	(2) 4,412,736	90,026	(3) 637	6,639,261
110020	Police Vehicle Replacement	1,517,125	(4) 1,557,400	42,221	(8) 1,515,244	1,601,502
110065	Police Capital Expenses	1,159,904	(9) 30,481	23,307	(10) 113,500	1,100,192
110066	Conducted Energy Weapons	207,194		1,912	(5) 209,107	-
112029	Vacation Liability Reserve	1,438,035		28,894		1,466,930
112030	Sick Leave Police	5,989,248		120,341		6,109,589
112210	Provision Police Litigation	254,733		5,118		259,851
112220	Police Special Events	111,252		2,235		113,487
112225	Rewards - Police Board	167,983	(6) 10,000	3,526		181,509
22218-000100	OMERS Type III (see note below)	462,839	(7) 85,466	10,588		558,893
TOTAL RESERVES		\$ 17,495,766	\$ 6,173,070	\$ 372,570	\$ 5,519,435	\$ 18,521,970

- (1) - transfer to ISD Reserve and Police Expenditure Capital per Board approval, PSB 16-068
- (2) - approved allocation of 2015 surplus per PSB 16-068 and Mountain Station construction recovery
- (3) - closing of capital project - land acquisition
- (4) - to fund Vehicle purchases, as per approved 2016 Budget
- (5) - transfer funds for CEW purchase
- (6) - transfer reward for unsolved homicide per PSB 15-062
- (7) - transfer funds back to OMERS Type III for CEW funding posted twice
- (8) - transfer funds to capital project to fund vehicle purchases
- (9) - transfer excess funds back to reserve for completed capital projects
- (10) - funds transferred to Operating Budget to fund one-time backup server and support license as approved by the PSB for the 2016 Budget

Note - OMERS Type III account represents the unused portion plus accumulated interest of the OMERS Type III surplus that was divided with the Hamilton Police Association, Senior Officers Association, the Chief and Deputies in 1997. These funds must be used in accordance with the agreement signed by the parties stated above. The monies must be used for specific improvements for the service and / or front line staff.



Hamilton

CITY OF HAMILTON
CITY MANAGER'S OFFICE
Audit Services Division

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

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.

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

**CITY OF HAMILTON
PERFORMANCE AUDIT REPORT 2017-01
RESERVES**

INTRODUCTION

Reserves are a key management tool used by municipalities in Canada. Reserves are utilized to respond to uneven and unpredictable revenues and expenditures. Reserves allow for the accumulation of funds over time for future funding of large capital and other one-time expenditures. Unexpected one time revenues such as grants or surpluses can also be set aside in reserves and used for a specified purpose or held to provide financial resiliency should unexpected events occur. The use of reserves can smooth tax and rate payers' burden, moderating tax and rate increases. Holding adequate reserves contributes to a City's sustainability as it provides a measure of financial flexibility to react to unexpected budget shortfalls or significant unexpected issues or events. The accumulation and use of reserves, however also needs to consider intergenerational equity. A planned approach to the use of reserves is considered good financial management.

The 2015 City Reserve Report reflects \$924.7 million in reserves, which was a \$46.8 million or 5.3% increase over the 2014 balance of \$877.9 million. These funds were held within 154 reserves, classified within one of three major types of reserve:

- Hamilton Future Fund Reserves (\$37.7 million – 2015)
- Obligatory Reserves mandated by legislation or By-law (\$226.2 million – 2015)
- Discretionary Reserves mandated by Council (\$660.8 million – 2015)

The City's total reserve balances compare favorably to other municipalities. Appendix C shows Hamilton as holding the second highest balances on a per capita basis. With respect to tax discretionary reserves, the City's reserves as a percentage of taxation have declined from 70% in 2011 to 58% in 2015. Hamilton's experience is the reverse of the average for municipalities in Ontario, which over the same period saw improving tax discretionary reserves as a percentage of taxation revenue.¹ Reserves are one of the many factors that need to be considered in assessing municipal financial health.

AUDIT OBJECTIVES AND SCOPE

The objectives of this audit were to:

- Assess if policy and procedures are appropriate to ensure good stewardship of reserve funds and support legislated requirements and best practices;
- Evaluate if reserve activity complies with policies and procedures and other authorized directions;

¹ As reported in BMA Management Consulting Inc.'s 206 municipal comparative study.

- Assess the sufficiency and transparency of reporting on reserves to Council and the public (considering accuracy, transparency and understandability). This will consider publicly available reports such as the budgets, Annual Financial Report (including the audited financial statements) Annual Reserve Report and Budget Variance Reporting; and
- Evaluate how the City's reserve funding supports the City's sustainability through:
 - Investment returns /allocations to reserves;
 - City's use and accumulation of reserves compared to best practice and generally accepted philosophy for Canadian municipalities' use of reserves; and
 - Borrowing from the reserves.

The scope of this audit encompasses all open reserves disclosed in the City Reserves Report as at December 31, 2015, which was the most current reserve report available at the time the audit was completed. While individual obligatory reserves governed by specific external agreements and legislation were not the subject of detailed review, they were included in procedures that related to reconciliation, reporting and transparency. Our detailed testing focused on the period from January 1 2015, to December 31, 2016. Trend analysis considered the five years from 2011 to 2015.

METHODOLOGY

The following audit techniques were used either individually or in combination:

- Review of applicable policies, procedures, reports, agreements and legislation.
- Interviews with various City personnel.
- Examination of reports and transactions and supporting documents.
- Research of best practice and other select municipalities' reserve usage.

The Audit relied on publicly available information as well as procedures, accounting records, and other documents as well as explanation and interviews with personnel to form the basis of the audit report and recommendations.

FINDINGS

1. Compliance with External Requirements, Policy and Procedure

City's reserves generally comply with external requirements

Reserves balances and activity is largely compliant with requirements provided by the Ontario Municipal Act (MA), the Public Sector Accounting Board (PSAB), and the City's own policies and procedures related to reserves. This includes recognizing Obligatory Reserves as deferred revenue and the discretionary reserves as part of the City's surplus. Audit services noted discretionary reserves shown in the Reserve Report erroneously included one small reserve that was reported as deferred revenue in the financial statements. Appendix B provides the list of approved reserve policies.

Additional procedures could better support compliance with PSAB

Audit Services identified several older discretionary reserves funded by grants that should have been reviewed to ensure they were not deferred revenue. Financial Reporting was unable to confirm their review at the time they were established and currently does not have a process in place to confirm the appropriateness of administrative recommendations for reserve set up.

Administration is not completing periodic reviews on a timely basis

ADM-01 Policy directs Administration to complete periodic reviews of reserves for policy compliance and relevance, and to provide action plans for maintaining Council approved funding levels. Since 2014 Administration has reviewed seven of the larger and higher priority reserves. However, at this rate it will take twenty-one years to review the remainder of the current reserves.

Need for better corporate oversight and decision making

There is currently one umbrella policy, governing general direction on reserves. The umbrella policy contains contradictory statements and would be enhanced by including requirements for better support, corporate oversight, and decision making.

The umbrella policy ADM-01 provided the following conflicting direction:

- Council is required to approve all reserve related transactions (set up, changes and all transactions) prior to occurrence, which can be completed through Council report, motion or the annual budget.
- Administration has the authority to "approve... ongoing activities of the reserves as per the reserves purpose, conditions and or restrictions." (Section 1.4)

Audit Services did not identify any circumstances where Administration directed reserve related activities without prior Council approval.

Audit Services noted that standard terms of reference that should be provided within policies for specific reserves were not outlined in the umbrella policy. The umbrella policy should include key terms of the reserve that would be documented when Council approves a new reserve, such as:

- The unique corporate purpose or need served by the reserve;
- Ongoing sources of funding;
- Ongoing uses of reserve funds;
- Target levels or ranges based on a related driver; and
- Corrective actions when reserve is under or over target.

This type of information ensures there is clearly documented understanding of a reserve's function. It can aid Council and Administration in better decision making, and evaluation related to reserves, and provide agreed upon content for the Annual Reserve Report.

Targets are lacking for the majority of reserves

Review of the Reserve Report found only 10 reserves with a target balance. The targets for the majority of reserves are noted as either; "to be reviewed" or "not applicable as one-time funding". Audit Services' noted that the Tax Stabilization Reserve balance has remained at less than 1/3 of the target balance in both 2014 and 2015, while the Unallocated Capital Levy Reserve has remained above its target over the same period; however, this balance is exclusive of future year commitments.

City needs to confirm and articulate their authority over Boards' reserves

Hamilton Library and Hamilton Police Service are governed by separate boards and consistent with existing policy maintain their annual operating surpluses in their own reserves. However, given funding reliance, existing policy and separate governance, Audit Services was unclear as to how and when the City could access these reserves if Council deemed it necessary. Once this is articulated within City policy, the Reserve Report should categorize the reserves to reflect Council's level of access and control over these funds.

2. Sustainability and Sufficiency of Reserves

Hamilton's reserves are generally keeping pace with operating expenditures

While discretionary reserves have become a slightly smaller percentage of annual expenditures over the last five years, Hamilton's balances are the third highest within the comparator municipalities. See Appendix C for more detail.

Hamilton's reserves cannot be easily assessed for sufficiency or excess using currently available information

The reserve contributions to fund capital and operating requirements can be determined from the analysis included with the Annual Reserve Report. However, it is challenging to identify which portion of reserve funds is available to fund each of the future years' operating and capital budgets. This is significant as reserves provide the largest single source of funding (2015-26%) for the annual capital budget.

Furthermore in the Reserve Report, while each reserve has a brief caption listing whether it is sustainable, there was rarely supporting evidence for conclusions. If the reserve is identified as unsustainable, remediating actions were not often listed.

Uncertainty in the adequacy of Tax Stabilization Reserve balance

For the Tax Stabilization Reserve there is a gap between the 2015, \$40 million target and the actual balance of \$13 million. While the desire to attain the target has been reiterated, Administration is projecting an even lower ending balance for 2016. Audit Services was unable to confirm any approved plan to move the reserve balance closer to its established target.

Audit Services also identified eight (8) reserves by description or activity that appear aligned to stabilization objectives, with a combined balance of \$88 million, which could be relevant to the question of adequacy. See Appendix D for details. In one of these reserves, we were advised that the risk of capital losses on investments may be adequately addressed with much lower balances than currently held. (Investment Stabilization Reserve, 2015- \$54 million). That balance was created by contributions of large capital gains over the last five years. There is currently no target for the reserve.

3. Efficiency and Effectiveness**Effective and efficient use of some reserves**

There are several reserves with purposes and functions commonly seen in other Canadian municipalities, which demonstrate characteristics that support effectiveness and efficiency such as:

- The Election Expense Reserve which responds to a specific corporate need;
- The Vehicle Replacement Reserves which accumulates significant funding for uneven capital expenditures; and
- The Rate Supported Reserves that hold surpluses generated from rate supported operations and provide funding for capital and rate stabilization.

While numerous municipalities, including Hamilton, have reserves to smooth winter road maintenance expenditures, Audit Services noted that the City's 2014 & 2015 winter maintenance deficits were not actually funded by the Winter Control Reserve. They were drawn down from operating deficits leaving the Winter Control Reserve intact. It is unclear if utilizing the surplus rather than the reserve is within Administration's discretion and is advisable for transparency or consistency.

Reserves are being used for many purposes, only some of which align to agreed upon outcomes

The following are the most common desired outcomes that reserves provide:

- Smoothing or moderating tax and rate increases;
- Funding the capital program and thereby reducing debt levels; and
- Providing financial flexibility and resiliency to respond to unexpected financial challenges.

Audit Services noted that the City's reserves are also being used for:

- Reporting funding and activity in sensitive or high profile areas; and
- Demonstrating accountability for donations and other specific receipts.

These purposes do not align with the outcomes provided above.

The large number of reserves does not support efficiency, effectiveness or strategy

As the number of reserves under administration increases so does Administrative effort, related to transactional processing, reporting and oversight. The City reports on 147 discretionary reserves, which is higher than both Calgary at 47 and Toronto at 115. Furthermore, Audit Services identified 22 reserves with minimal activity in the last five years. Appendix E lists the reserves. Many of these reserves have small balances and narrowly defined scope for use of funds.

Each year smoothing tax and rate increases requires a certain contribution to and from reserves and achieving that with large numbers of small transactions is less efficient. Within the Income Stabilization Reserve, the combined funding for the Pilots and Ontario Municipal Board Appeals (OMB) of \$1,326 million was the result of 69 individual transactions ranging from \$1,000 to \$250,000. Higher volume low value transactions are typical for many of the reserves. Changes to both budgeting practices and the approved uses for the reserves could result in recognizing the same amount of reserve support more efficiently.

Internal loans from reserves provide some benefit to taxpayers

Council has authorized from reserves, internal loans with specified terms and rates comparable to external borrowing. The loans result in reduced external expenditures. In some cases operating savings fund internal debt servicing with no impact on property taxes, but when this is not the case, these loans impact property taxes in the same way as if the borrowing was made from a third party, as interest is provided to the loaning reserves. While these transactions result in lower corporate debt and higher interest contributions in reserves, they increase the complexity of reserve transactions, and require additional controls and reporting. Thus the use of internal loans needs to be prudently managed so as to have clear cost/benefit advantage.

4. Strategy and Planning**An overall reserve strategy is absent**

Finance Management acknowledge that while there is analysis of various components of mid and long range financial planning there is no formal comprehensive plan in place that outlines how the City will establish, fund and utilize its reserves over the next five to ten years to achieve the City's objectives. As a result:

- Administration has no high level end target to inform their decisions; and
- Reserves outcomes are the result of tactical actions rather than strategy.

This issue is especially relevant as the City moves to multi-year budgeting. Reserve strategies can impact many areas including administrative burden, behavior, and transparency and ease of understanding for stakeholders, Council and administration. Once strategy has been formalized, reserve policy can be aligned.

Funding strategy for employee related liabilities is needed

The City's significant employee benefit liabilities are partially funded from a variety of reserves that align to different components of the liability. In addition to these reserves, the Claims Fluctuations Reserves intended for smoothing annual budgeted employee benefit costs have a combined balance of \$23.6 million. Over the last 5 years only surpluses have been transferred to the Claims Fluctuations Reserves, suggesting reserve overfunding. Audit Services was unable to find support justifying the need for the high reserve balance. The 2015 employee future benefits liability compared to 2015 funding is shown in Appendix F-1.

Reserves compared to the total liability has remained consistent at around 30% over the last five years, however the funding approach is fragmented and Administration confirms that they have not developed formal funding strategies. There are no targets for funding each component, nor the liability in total. Audit Services notes that not fully funding these liabilities increases the risk that intergenerational funding could be required in the future. Appendix F-2 shows funding levels for 2011-2015.

5. Reporting and Transparency

Reporting around reserves is voluminous and fragmented

Reserves information is provided in the Audited Financial Statements, the Reserve Report, Budgets and Periodic Budget Variance Reports.

However, variance reporting is aggregated to a level that hinders transparent reporting, meaning that some reserve transactions and reserves activity is not fully disclosed. For example, within 2015 Non Program Revenues, unbudgeted capital gains of \$3.1 million (2014- \$8.3 million) were transferred to the Investment Stabilization Reserve, eliminating a large favorable variance, and no discussion is provided within the year end variance reports (FCS15052 (b) FCS14047 (b)). The result is that a significant revenue variance is buried in other transactions. A better approach would be to have a system and format that provides full accountability and transparency. Toronto's reporting of unbudgeted transfers to and from reserves is an example of how increased transparency can be provided.

Reconciliation and explanation of differences between Reserve Report and Audited Financial Statements is not completed

In the course of our audit work we found differences between the Annual Financial Statements and the Reserves Report. Although 2015 differences were immaterial, there was no evidence of a process to reconcile the numbers in the two reports, or identify how the information in the reports agrees or differs. Linking Reserve Report totals to the Audited Financial Statements would provide more transparency and assurance to the report reader.

Usefulness of the Reserve Report falls short of expectations

The Reserves Report provides large amounts of information for a large number of reserves and requires a significant investment of time to generate and review. However, it's not easily understood. At least partially due to staff changes, the 2015 report was also not available until January 2017 which further impacted its usefulness. The benefits provided to users such as the staff, Council and the citizens are uncertain and in our view could be enhanced.

Our basic premise is that the Reserve Report's value is dependent upon its understandability to the users. Audit Services noted individual reserve narratives that to varying degrees were incomplete, out of date, or not easily understood. The use of acronyms and inconsistent levels of detail compromised its quality.

Also, reporting by major types of reserve transactions could be improved. The Reserve Report summary report provides valuable summary information related to the major types of funding into and out of the reserves broken down by reserve category.

However within the individual reserves, while interest revenue is disclosed separately, other activities are described in a large variety of ways, which all fall under one of the following categories:

- Allocations to Capital Fund;
- Allocations to Operating Fund;
- Allocations from Operating Fund;
- Allocations from Capital Fund;
- Repayment of internal loans;
- Internal loans; or
- Transfer between reserves.

We note that other municipalities provide reserve reporting in various formats that are more transparent. While Calgary provides a similar detailed presentation of each reserve, Toronto provides periodic reporting in tabular format, relating to budgeted and actual reserve activity and loans activity.

Unclear reporting of operating surplus distributions

The City's annual operating surplus created by the excess of revenues over expenditures is transferred to reserves in accordance with Council's direction. Audit Services expected that approved transfers to specific reserves shown in the Year-end Variance Reports would occur in the same year as they were created and match to the specific reserves noted. While the 2015 reporting on the Rate Supported and Police surpluses matched the Reserve Report, other amounts reported were not shown in the 2015 Reserve Report (however may be reflected in 2016) and the Library reserve transfer was shown as one amount but recorded between two reserves in the Reserve Report. With such presentation, and lacking full explanation, it makes it difficult for the public to understand the impacts on the reserves.

Reporting of prior commitments of reserve funds is not formalized

Audit Services noted that future year projections provided for each reserve are being generated inconsistently. Some projections include only the following year's approved amounts. Others include amounts that have been approved in budget, report or plan for a number of future years. To ensure that reserves are not overcommitted, Administration identified a need to have readily available information on all commitments, which should be consistently defined.

Adequate and transparent reporting on loans from reserves is lacking

Reporting of the loans is limited to the recorded total repayments of \$18.2 million in the 2015 Reserve Report analysis as well as the details within the individual reserves. Reporting related to the cumulative loans repayable to reserves was not readily available as at each year end, and Administration did not undertake formal oversight processes to ensure that loan repayments were made according to schedule.

RECOMMENDATIONS

1. That Financial Planning & Policy ensure that Reserves are being employed to support corporate sustainability. Accordingly, Management should:
 - Develop a reserve strategy in conjunction with longer term financial plans including the capital management plan; and
 - Provide ongoing education and communication of the strategy to ensure that tactical reserve activities are aligned with strategy.

Management Response: Agreed. Initial work can begin in 2017 towards developing strategies related to obligatory and discretionary reserves. These strategies will have to be amended from time to time to reflect draws on reserves for unplanned corporate or council priorities. Completion by Q4 2019.

2. That Financial Planning & Policy ensure that Employee Benefit Liabilities are appropriately funded in accordance with an approved funding strategy and the related applicable reserves strategy, giving consideration to the impact on fiscal responsibility and intergenerational equity.

Management Response: Agreed. Completion by Q2 2018.

3. That Financial Planning & Policy ensure that reserve strategies outlined in recommendation 1 & 2, include targets based on appropriate drivers for key reserve areas, such as Stabilization, Vehicle Replacement and Employee Benefits. Plans to achieve and maintain the reserve targets should be approved by Council and then financial requirements included within annual operating budgets.

Management Response: Agreed. Targets and strategies for Stabilization, Vehicle Replacement and Employee Benefit Reserves will be updated and presented for Council's consideration by Q3 2018. Management will continue to work annually with internal clients in an effort to deliver the planned development of three reserve policies and targets. As part of the annual budget processes, staff will present to Council strategies confirming the required investments or service level amendments to achieve said targets, recognizing competing interests, including tax competitiveness.

4. That Financial Planning & Policy rationalize and streamline the existing reserves, with the goal of building and retaining reserves with significant ongoing funding sources, and a defined corporate purpose. Management should close the majority of low activity reserves, particularly when those reserves do not serve a corporate need. The goal of the reduction in total reserves should be to increase the effectiveness and efficiency of reserve and Administrative activity.

Management Response: Agreed. Staff and Council will be consulted annually as reserves are rationalized and the number of reserves is reduced. By Q4 2017, staff will present options for Council's consideration in an effort to begin the rationalization of reserves, including those referenced in this report.

5. That to facilitate better analysis, and improve transparency, Financial Planning & Policy should classify the discretionary reserves according to the operating or capital activities they fund. The larger number of categories currently used should be reviewed and kept only if they provide useful information for analysis and understanding of reserve activity.

Management Response: Agreed. While reserves are categorized for existing reporting purposes including categories for capital related reserves, further review will be undertaken. Completion by Q2 2018.

6. That Financial Planning & Policy should implement budgeting processes that align with the following principles:
 - Establishment and utilization of reserve funding primarily for corporate purposes;
 - Requiring fewer and higher value transfers to and from reserves; and
 - Transparency for both budgets and reserves.

Management Response: Agreed. The principles above will be considered in the development of the reserve strategies and multi-year budget development. Completion by Q4 2019.

7. That Financial Planning & Policy should develop umbrella policies aligned with the Corporate Reserve Strategy. In addition to the content provided in the current umbrella policy there needs to be:
 - Clearly articulated and aligned roles and responsibilities of Administration and Council; and
 - Guidance on acceptable reserve purposes and areas that may generally be less appropriate, including low value funding or reserves, one-time funding and very specific purposes.

Specifically required documentation of terms and conditions prior to reserve approval, such as:

- Ongoing sources of funding;
- Ongoing uses of reserve funds;
- Target levels or ranges based on a related driver;
- Corrective actions when a reserve balance is under or over target; and
- Direction for subsidiaries' responsibility for reserves and retention of surpluses.

Management Response: Agreed. With respect to corrective actions, those would be presented through budget reports/deliberations or stand-alone reports. Completion by Q2 2019.

8. That in conjunction with the rationalization of reserves, Financial Planning & Policy should ensure that Council approved amended terms and conditions for each individual reserve are complete, consistent and are readily available as Policy or in some other similarly accessible format.

Management Response: Agreed. Completion by Q2 2019.

9. That Financial Planning & Policy should investigate alternative formats for Reserve Reporting, including tabular formats for their value to external users, and the ease of preparation.
 - Management needs to ensure that any information provided is timely and understandable.
 - Management should provide appropriate linkage of information related to reserves reported in the audited financial statements and budget variance reporting.

Management Response: Agreed. Completion by Q2 2019.

10. That to ensure transparency, Financial Planning & Policy should provide annual reporting on:

- The details on the outstanding loan balances for internal loans provided from specific reserves, as well as loan terms including annual repayments; and
- Significant variances between budgeted and actual reserve transactions.

Management Response: Agreed. Completion by Q3 2017.

11. That Financial Planning & Policy ensure that processes for creating reserves funded by specific grants, support maintaining compliance with PSAB. Management should update reserve set up processes to include review by Financial Services for financial reporting requirements.

Management Response: Agreed. Formal procedures to ensure that grants provided by provincial and federal governments are appropriately recorded will be developed by Q4 2018.

12. That once the reserves have been rationalized, Financial Planning & Policy needs to develop an ongoing review plan for all active reserves, to ensure that they are reviewed within a reasonable timeframe. Management needs to determine clear and understandable criteria for evaluating the appropriateness of a reserve, informed by the desired corporate outcomes for reserve usage.

Management Response: Agreed. A plan will be developed which incorporates the staffing resources required to review all reserves and considers other divisional priorities. The plan will be developed by Q4 2018.

13. That Financial Planning and Policy should develop readily available reporting on approved reserve funding commitments for each reserve. Rules and processes are required to ensure that the information is provided on a consistent and comparable basis, supporting understandability.

Management Response: Agreed. Completion by Q3 2017.

CONCLUSION

Like many municipalities, the City utilizes reserves to respond to uneven revenues and expenditures, and support financial flexibility. The 2015 Reserves Report reflected \$924.7 million in reserves, of which \$660.8 million were discretionary reserves mandated by Council. While the City's reserve balances compare favorably to other municipalities, corporate strategy including targets is needed to determine the adequacy of reserves to support sustainability. Strengthened policy stipulating the requirements for reserves could facilitate more efficient and effective activity by having fewer and larger reserves supporting corporate objectives. Improved reporting on annual reserve activity, as well as reserves loans and commitments of reserve funds will provide greater transparency, accountability and understandability. Periodic evaluation of reserves and related reporting is required to ensure that reserves continue to meet their specified objectives as priorities and the environment changes.

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LIST OF COUNCIL-APPROVED RESERVE POLICIES

Policy Number	Policy Name	Date of Approval	2015 Balance (\$millions)	2015 Target (\$millions)
General Reserves Policy				
Policy ADM-01	Reserve Policy Administration of Financial Reserve Funds (FSC14028)	May 2014	Not applicable	Not applicable
Specific Reserves Policy				
Stabilization -110046	Tax Stabilization Reserve(FSC14028)	May 2014	12.1	49.0
Capital - 1080820	Unallocated Capital Levy Reserve(FSC14028)	May 2014	32.3	24.0
PW Waste- 112270	Waste Management Recycling Reserve(FSC14028)	May 2014	4.0	4.0
Operating- 112243	Enterprise Fund Reserve(FSC14028)	May 2014	1.0	Not applicable one-time funding
Rate-01	Rate Reserves (FCS16056)	June 0216	117.2	44.0 to 179.0
FCS-DC1	Development Charges Reserve Policy	May 2013	131.0	No targets provided
FCS05111	Reserve General Policies Covering the following:	October 2015		No targets provided
	• Hamilton Public Library (9 reserves)		7.3	
	• Vehicle and Equipment Replacement Reserves (15 reserves)		64.5	
	• Winter Control Reserve (1 reserve)		3.1	
	• Employee Related Pension and Benefit Costs (9 reserves)		98.3	
Police Board Policy				
Police	Police Operating Budget Surplus (Deficit) Retention Policy & Police Tax Stabilization Policy (PS15-059)	April 2015	9.5	No targets provided

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**RESERVE BALANCES FOR CANADIAN MUNICIPALITIES AND
CITY OF HAMILTON TRENDS**

Table 1 – Comparison of Reserve Balances for Selected Canadian Municipalities

	Hamilton	Calgary	Edmonton	Winnipeg	Toronto	Ottawa	Mississauga
Total Reserves in \$millions (1)	699	1,876	376	303	1,558	557	354
Op Expenditure in \$millions (1)	1,627	3,586	2,777	1,486	10,826	3,275	774
Rsrv as % of Op Expenditure	43%	52%	14%	20%	14%	17%	46%
Per Capita Rsrv Value	1,269	1,525	420	422	551	580	463
Population in 000's (1)	551	1,231	895	718	2,826	916	764

(1) Numbers obtained from 2015 Annual Financial Reports.

Table 2 – City of Hamilton Reserve Balances from 2011–2015 (in \$000s)

	2015	2014	2013	2012	2011
Discretionary and Obligatory Reserves	924,707	877,929	864,485	825,387	782,038
Discretionary Reserves	698,497	683,089	689,050	697,598	676,878
City Operating Expenditures	1,627,190	1,541,690	1,473,567	1,469,292	1,454,235
Total Rsrv as % of Op Exp	57%	57%	59%	56%	54%
Discret. Rsrv as % of Op Exp	43%	44%	47%	47%	47%

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**CITY OF HAMILTON STABILIZATION RESERVE BALANCES
AS AT DECEMBER 31, 2015**

Reserve Name	Balance (in \$000)
Commodity Stabilization Reserve	1,690
Tax Stabilization Reserve	12,134
Grants and Subsidy Reserve	908
Claims Fluctuations Reserve Health/Dental City	17,749
Claims Fluctuations Reserve Health/Dental Police	5,804
Investment Stabilization Reserve	54,168
Library Major Capital Projects	1,256
Tax Stabilization – Police	4,050
Total	97,759

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LIST OF RESERVES WITH INSIGNIFICANT ACTIVITY FROM 2011 – 2015

Reserve Number	Reserve Name	2015 Ending Balance (\$)	Date Established
112050	Retirement Gratuity Reserve - HSR	157,640	1997
112249	Downtown Housing Initiatives	23,486	2005
102045	Emergency Repair Program - HHERP	252,651	2001
112009	Homestart Program	351,138	2006
112207	Upwind & Downwind Conference	19,516	2004
106011	Redeploy & training Fund (Library)	517,637	2001
106012	Youth Programming Reserve (Library)	121,900	2004
100045	Services for New Subdivisions	3,459,471	1964
115090	Cash in Lieu Sidewalks - Flamborough	185,852	1993
117012	Developer Deposits - Roads	920,845	Unknown
100005	Revolving Fund Historic Properties	409,939	1980
112211	Heritage Studies Reserve	41,816	2005
115085	HMPs Cash in lieu Parking Reserve	207,927	1989
100036	Auchmar Estates Repairs	9,141	2003
104005	Special Events Subsidy	2,388	1986
112029	Provision For Vacation Liability	1,438,035	2005
112210	Provision for Police Litigation	254,733	1986
112220	Police Special Events	111,252	1978
113022	Garbage Collection Contingency Reserve	16,046	1998
112223	Ivor Wynne Community Fund	27,932	2011
110010	Meter Replacement	5,488,599	1990
113008	Future Sidewalks Ancaster	54,923	2000

**CITY OF HAMILTON
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EMPLOYEE BENEFIT OBLIGATIONS AND RELATED RESERVES

**Table 1 – 2015 Accrued Employee Benefits Obligation Compared to Funding
(in \$000s)**

	Liability	Reserves
Sick Leave Benefit Plan	55,029	7,550
Long Term Disability	22,729	17,169
Workplace Safety & Insurance Board Liabilities	75,572	42,936
Retirement Benefits	138,789	-
Vacation Benefits	26,077	1,438
Pension Benefit Plans	26,268	-
	<u>344,464</u>	<u>69,093</u>
Net Unamortized Actuarial Gain	4,543	-
Pension & Retirement Reserves	-	3,698
Other Benefit Reserves	-	26,927
Total	<u>349,007</u>	<u>99,718</u>
Less: Funded liabilities	<u>22,380</u>	
Total Unfunded liability	<u>326,627</u>	

**Table 2 – Reserve Funding Attributable to Accrued Employee Benefit Obligations
(in \$000s)**

	2015	2014	2013	2012	2011
Accrued Benefits Obligation	349,007	334,709	318,645	307,514	288,993
Employee Related Reserves Total	98,280	99,355	94,240	89,795	84,598
Provision for Vacation Liability Police	1,438	1,406	1,373	1,341	1,308
Total Reserve	<u>99,718</u>	<u>100,761</u>	<u>95,613</u>	<u>91,136</u>	<u>85,906</u>
Funding Percentage	29%	30%	30%	30%	30%