



Hamilton

Office of the City Auditor

# Hamilton Future Fund Audit

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**Office of the City Auditor**

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**Executive  
Summary**

The Council-approved Office of the City Auditor Work Plan 2019-2022 (Report AUD19007) included a compliance and value-for-money audit of the Hamilton Future Fund (HFF).

The Office of the City Auditor (OCA) reviewed the HFF’s fund governance and oversight including the processes to manage grants and loans, and the adequacy of performance measures. The OCA has brought forward ten recommendations to strengthen fund governance, including:

- Development of a strategic plan for the use of funds, which incorporates public consultation;
- Formalization of the roles of City employees to support the HFF, including a fund administrator;
- Improvements in the processes for grant awards; and
- Monitoring of performance measures for projects receiving funding.

Management agreed with all 10 of the recommendations. Comprehensive management action plans are to be provided to the OCA by June 2022.

**Strengthening Hamilton Future Fund Governance**



## Introduction and Background

The HFF was established in 2002 when Hamilton Hydro was sold for \$137M. Two reserve funds were created:

- \$100M invested to provide income which will be used to fund various projects and initiatives (Fund A); and
- \$37M to provide funding for various City and community organizations and initiatives (Fund B).

The mission of the HFF is to create a permanent legacy for current and future generations of Hamiltonians to enjoy economic prosperity and improved quality of life. Fund A projects have included, for example, grants for major capital projects for the 2015 Pan-Am Games, and construction of affordable rental housing as part of the Poverty Reduction Investment. Fund B grants were awarded, for example, for the capital improvement or construction of sports facilities and for the construction of a common area in a residential hospice.

The Board of Governors was established to provide oversight to the HFF. The Board is composed of the Mayor, four City Councillors and 13 citizen members.

The Board of Governors is a sub-committee of the General Issues Committee (GIC) of City Council; and makes recommendations regarding the use of the HFF reserves.

According to reports prepared by Finance; the preliminary reserve balance (as of December 31, 2019) in the HFF was about \$49M in Fund A, and about \$1.8M in Fund B. The preliminary reserve balances reflect the activity in the HFF since inception; which includes loans and grants awarded, investment income and loan repayments.



## Audit Objective

The overall objective of the audit was to perform an assessment of the effectiveness of the HFF, including:

- Fund governance and oversight;
- Adequacy of the processes to manage grants and loans;
- Sufficiency and transparency of reporting of the fund financial position, including investments to the Board of Governors and GIC; and
- Adequacy of performance measures including the outcomes achieved from the HFF grants and loans.

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## Audit Scope

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The audit scope included governance, oversight and management processes. The focus of the audit was on 2018 and 2019 financial information, with historical data and records reviewed as required.

The OCA notes that the most recent final year end reporting is the year ended December 31, 2018. The OCA also reviewed preliminary year end reporting for the year ended December 31, 2019. Year-end reporting for December 31, 2020 was not available at the time of audit fieldwork and report writing.

## What We Did

- 1) Gained an understanding of HFF governance, oversight and management processes.
- 2) Assessed processes and controls in place for fund governance, oversight and management. HFF financial information and reporting was reviewed for 2018 and 2019. Fund B grants were reviewed for the most recent applications made in 2018/2019.

## How We Did It

- Researched best practices for grant programs and reserve funds;
- Interviewed relevant staff;
- Reviewed governance over the HFF programs, including relevant processes, procedures, and administrative practices;
- Examined financial reports and supporting documentation;
- Reviewed a sample of grant applications and awards for Fund B; and
- Compared HFF governance and administrative practices to those of other City of Hamilton programs such as the City Enrichment Fund.

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## Detailed Findings

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The HFF is a reserve fund created in 2002 from the sale of Hamilton Hydro for \$137M. The funds are to be used for various capital projects for both the City of Hamilton and community organizations.

HFF program management includes the process of:

- Determining the strategic direction for use of funds;
- Review of applications and requests for funding, including the evaluation and awarding of loans and grants for capital projects;
- Contract management of loans and grants through the review of progress reporting during and upon completion of projects;
- Investment and financial reporting of the reserve balances; and
- Performance measures to determine if value-for-money was achieved for the funded projects.

### Accountability Framework Needs Improvement

A formalized accountability framework for the management of the HFF provides rigour and transparency to the processes for the Board of Governors, City staff, and grant/loan recipients.

Formalized processes and procedures ensure that HFF grants and loans are managed in accordance with sound governance principles in order to ensure that program objectives are achieved.

HFF has some aspects of an accountability framework including:

- Mission statement and guiding principles to assist in fund management and the use of funds;
- A Board of Governors with defined roles, responsibilities and accountabilities to provide oversight to the HFF;
- GIC and Council provides additional oversight by approving the recommendations made by the Board of Governors for the use of funds;
- Investment of unused funds is managed internally by the City's Chief Investment Officer;
- Processes are in place for grant applications, selection and awards; and
- Regular reporting to the Board of Governors of the financial status of the HFF, including the investment returns of uncommitted funds.

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## Detailed Findings

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Oversight of the HFF, however, could be improved:

- Overall strategy as to the use and nature of fund investments could be improved;
- HFF has no terms of reference, even though this was requested by the General Issues Committee;
- There is no Fund Administrator (City staff) assigned to ensure that all requirements of the HFF applications, contracts and financial reporting were met;
- Roles, responsibilities and accountabilities of City staff are not clearly defined as to how they support the HFF;
- Board of Governors does not have a regular meeting schedule, and does not open funding applications on a defined schedule;
- Community consultation for input on HFF project funding has not occurred, as per the HFF's guiding principles;
- Management of grants needs to be formalized, including the clarity and consistency of scoring of applications for approval; and
- Reporting of performance measures and successes of the HFF grant and loan recipients could be improved.

### Overall Strategic Direction of the Funds Needs Strengthening

A strategic plan for the use of the HFF reserve helps ensure fund transparency, sufficiency and that the mission and guiding principles are achieved. A plan for the use of the HFF can help ensure the most effective use of taxpayer funds that benefits the community. A reserve strategy for the HFF can outline how the funds will be used, for example, over the next five to ten years.

The plan for the HFF should also be in alignment with the strategic plan for the City of Hamilton and the results of public consultations on the best use of funds. HFF investments could incorporate and contribute to the strategic priorities for the City; for example, Economic Prosperity and Growth, Healthy and Safe Communities, Built Environment and Infrastructure, and Culture and Diversity.

Currently, there is no comprehensive plan in place that outlines how the City will use the HFF reserve, for example, over the next five to ten years. Also, the guiding principles for the HFF could be better defined to help determine the most effective use of funds.

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## Detailed Findings

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### Hamilton Future Fund Mission and Guiding Principles

The HFF has an established mission statement and guiding principles that were developed when the fund was established in 2002. The mission of the HFF is to create a permanent legacy for current and future generations of Hamiltonians to enjoy economic prosperity and improved quality of life.

Guiding principles of the HFF include:

- Investments provide permanent community benefit;
- Investments improve the economic prosperity of Hamiltonians;
- Fund should be self-sustaining;
- Investments should achieve specific, measurable results;
- Fund management should include a clear accountability framework; and
- Fund management should be transparent and include community consultation.

### Roles, Responsibilities and Accountabilities of Board of Governors and City Staff

The role of the Board of Governors was established by the Committee of the Whole in 2002 (now GIC) to:

- recommend to Council future uses of \$100M fund that will be invested over the next five years;
- develop performance criteria and future investment priorities and make recommendations to Council;
- obtain public input on future directions and priorities;
- track HFF performance and ensuring project benefits are completed and benefits materialize; and
- issue an annual report on the operation of HFF (revenues, expenditures, projects initiated/completed, and investment performance).

The Board of Governors meets according to the discretion of the Chair. There is no defined schedule for meetings. The last meeting was held in January 2020. There is also no fund administrator (City staff) assigned to provide oversight and support to the HFF. Finance staff, however, have reported regularly to the Board of Governors on the HFF Reserve Balances for both Funds A and B. A Legislative Coordinator from the Office of the City Clerk has supported the Board of Governors' meetings; and by receiving and organizing grant information for Fund B.

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## Detailed Findings

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In addition, the City's Chief Investment Officer has the responsibility to invest the unused funds and to report on the investment results annually. The HFF investment performance is reported as part of the City of Hamilton's Annual Reserve Fund Report and uses a similar investment strategy. In the creation of the HFF, Council directed staff to provide Council and the Board with regular reports on the status of the HFF reserve and projects funded from the HFF (FCS02107). However no formal reports of status and activity have been tabled since the 2018 calendar year. In the past, regular reporting meant at least annually. While preliminary HFF reserve balances were reported for the year-ended 2019, full reports have not been issued for the year-ended 2020 or 2021.

### Fund A

HFF Reserve Fund A of \$100M was to be invested and protected for a five-year period from inception of the HFF in 2002 to provide investment income as a permanent source of funding. It was anticipated that funds would be used for projects that would otherwise be unaffordable if funded from City's Capital Levy. After the five-year initial investment period and growth of the HFF; the funds could be used for capital projects. After the five-year period a community consultation was recommended to obtain input before any further spending allocations were made.

Significant uses of Fund A since inception include:

- Reduction of property taxes from the transfer of \$13.8M investment interest from 2003 to 2008;
- Loans to the City of Hamilton from 2005 to 2017 for about \$98M (approved through a By-law) to fund various capital projects;
- Grants for the Poverty Reduction Investment for construction of affordable rental housing for a total of \$20M paid from 2017 to 2021;
- Grants for \$55.2M in 2009 for capital projects related to the 2015 Pan-Am Games; and
- Loans to external organizations for capital projects for the McMaster Health Campus (\$10M), Good Shepherd Centre (\$5M), and Bob Kemp Hospice (forgivable loan for \$1.5M).

The reduction in property taxes, grants and loans from the HFF were approved by Council.

Fund A investments, however, were not protected during the first five-year period, as was required when the fund was established. Funds were to be invested and allowed to grow for sustainability over the five-year period. Some of the funds were used during the first five years to reduce taxes, and on loans to the City for capital projects. The loans to the City were promissory notes to be repaid to the

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## Detailed Findings

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HFF with interest. These loans were an alternative to taking on external debt to finance capital projects; and the principal and interest is repaid annually.

Subsequent major expenditures from the fund as noted above, were for capital projects that would provide permanent community benefit and could improve the economic prosperity of Hamilton residents; and would be in alignment with the guiding principles. However, community consultations regarding the use of funds have not been undertaken. Community consultation can help determine the funding priorities of future capital projects, such as investments in, for example, affordable housing, reducing homelessness, transportation, and climate change.

Based on past Fund A investments, funds have mainly been used for internal City projects, rather than for capital projects for external organizations. Community consultation could also help determine the mix of fund investments that would be allocated to both external organizations and the City of Hamilton programs.

Community engagement and input is an important part of achieving the 2018 to 2022 Term of Council priorities (particularly the priority of Trust and Confidence in City Government), and therefore the HFF should ensure public input into the allocation of HFF community investments.

According to management reports, the preliminary projected reserve balance of Fund A as of December 31, 2019 was about \$49M. The \$49M does not include the value of loans payable back into the fund, which will accrue over the coming years. It is expected the fund will gradually replenish itself from:

- repayment of loans with principal and interest; and
- investment income.

According to Finance's estimates as of December 31, 2019, the fund is expected to grow to \$99.7M by 2028 due to investment income and loan repayments. However, the projected growth of Fund A is based on an assumption that no new grants or loans are withdrawn after 2021.

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## Detailed Findings

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### Fund B

Fund B, which was \$37M at inception of HFF, was to be used to provide funding for various capital projects both within City programs and for external organizations. The funds are grants which are awarded as part of an application process.

Spending portfolios for Fund B were established in 2002 as key areas of focus for funding of various City and community organizations and initiatives. The spending portfolios included three investment categories:

- Enhancing Hamilton's Economy;
- Enhancing Hamilton's Social Fabric; and
- Enhancing Hamilton's Community Life.

Investment in downtown Hamilton was also considered a high priority; with a recommended \$16M to be set aside for downtown investment.

Grants are awarded by the Board of Governors and receive final approval from GIC and Council. The Board of Governors is responsible for ensuring that the Fund B grant awards adhere to the guiding principles and the investment categories. The grant application process, however, is not opened on a defined schedule such as on an annual basis.

According to management reports, the estimated uncommitted balance in Fund B was about \$1.8M at the end of 2019.

### Fund B Grants Processes

The process of reviewing applications and awarding grants is managed by the Board of Governors. Fund B grants were last awarded in mid-2019; based on the application process which was open from late 2018 to early 2019. There were 34 applications for funding with seven grants awarded for about \$1.3M.

Prior to this, grant applications were open in late 2017; with grants awarded in early 2018. There were 38 applications for funding; with nine grants awarded for about \$1.5M. Grant recipients and amounts awarded are posted on the City of Hamilton website.

Formalized processes and procedures ensure that grants are identified, awarded and managed in accordance with sound governance principles, ensuring that program objectives are achieved.

Grants program management includes the process from the initial application for funding, evaluation and awarding of the grant, progress monitoring, and final

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## Detailed Findings

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reporting upon completion of the project. Since the terms of the funding and the project are laid out in an agreement signed by both the City of Hamilton and the grant recipient, contract management practices can be applied to ensure accountability and transparency for the use of grant funding.

In our audit we found there were no formal policies or procedures regarding the awarding of grants from Fund B. There were, however, informal procedures and/or a methodology used by the Board of Governors to award grants.

We found some elements of an accountability framework for Fund B grants that were in place, as follows:

- Grant applications were formally reviewed and approved by the Board of Governors;
- Standardized forms and requirements were developed and used for grant applications;
- Grant applicants were required to state how the project aligned with program objectives and provide outcome measures specific to their project;
- Grant applicants were required to provide a project budget and financial information;
- Grant recipients entered into a standard agreement with the City of Hamilton outlining the nature of the grant, payment, and conditions for funding; and
- Progress reports were required to be provided six months after receipt of funding.

However, there were limited formalized guidelines and procedures for the management of the Fund B grants in the following areas:

- Clarity and consistency in the scoring of grant applications for approval;
- Compliance with the grant agreement, including adherence to planned expenditures and project outcomes; and
- Clarity around the City's ability to exercise the right to audit grant recipients.

In addition, HFF grants program records are not centralized; but are maintained in different City departments. The Legislative Coordinator receives and maintains grant applications and progress reports, which are forwarded to the Board of Governors for review. After approval of the grants by Council; Finance maintains the signed grant agreements and arranges for the authorization and payment of funds to grant recipients. The Board of Governors retains their documentation for the review and evaluation of grant applications. Overall, there is no centralized staff review of the grant documentation for compliance with the applications and processes in order to assist the Board of Governors.

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## Detailed Findings

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### Review and Approval of Grant Funding Requests

The standardized application for proposed projects includes:

- Alignment with the objectives and principles of the HFF;
- Overview of the capital project to be provided, including goals and objectives;
- Project budget, including financial statements and other sources of funding; and
- Performance measures to demonstrate the achievement of program goals.

Grant applications are reviewed at an HFF Board meeting. A checklist is used to assist Board members in the objective and consistent selection of grants applicants. The checklist aligns with the key requirements for projects outlined in the application form. Those grants which do not meet the minimum requirements of the application are rejected. Applications meeting the minimum requirements can also be ranked from A to D; but this does not involve scoring each category in the checklist. The ranking is an approximation that may be used to assist Board members in prioritizing applications; but is not required. In addition, the checklists are not maintained to help support the decisions to approve or deny applicants.

All grant applications are reviewed and discussed at the Board meeting. The Board then makes the decision to approve or deny the grant; or obtain further information from applicants. General reasons were provided by the Board as to why the applicants were approved or denied. There was no discussion of the ranking of each project according to the checklist.

While the application reviews are transparent, and discussed publicly, the checklist used by Board members to determine the grant recipients needs a more formal scoring and ranking of the key elements of the application form to help ensure fairness and transparency of the process and remove potential bias for certain projects. The Board has recently formed a working group to improve and enhance the grant selection criteria and scoring. In addition, projects that can enhance equity, diversity and inclusion in Hamilton could be added in the future as part of the selection criteria. Equity, diversity and inclusion is an especially important consideration given the capital nature of the grants, which can provide permanent benefits to the community.

Furthermore, the Board has had recent discussions that it would be useful for City staff to offer HFF information sessions to assist potential grant applicants to understand the requirements of the process; and therefore, make a stronger application. These sessions would assist new organizations or individuals, who may have limited understanding of the grants process to make a more competitive application.

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## Detailed Findings

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### Contract Management of Grants Programs

Contract management of approved grants programs helps ensure that funding is used by recipients in accordance with their agreements. Without formalized processes for the contract management of HFF grants, the Board assumes the risk that projects will not be successful and will not provide value-for-money.

Project objectives and expected outcomes are outlined in the grant applications. In addition, the agreement with the recipient forms the basis for contract management of the grant. The grant agreement briefly states the project for which the funds were approved.

The grant application includes language that a follow-up report should be provided after six months as to the status of the project. However, the grant agreement with the City does not require grant recipients to provide progress reporting after the funds are received. A final report at the completion of the project is also not required, although some smaller projects may be completed within six months.

Progress and/or final reports for funded projects are critical to enable effective contract management for HFF projects, as they should contain the following important information (per HFF Grant Application):

- Reporting timeline to meet the funding request;
- Specific performance criteria;
- Clearly articulated and expected outcomes;
- Indicators for measuring the achievement of expected outcomes; and
- Regular reporting to HFF Board on the achievement of outcomes.

The Legislative Coordinator sends a reminder letter to grant recipients if a progress report has not been received within the first six months. There is no City staff administrator to follow-up on the status of the projects and review the submission, including the use of funds. As a result, some projects may not report out on a timely basis, and the Board is uncertain as to whether the funds were spent for the intended purpose, and whether the project progressed in a timely fashion.

The progress reports are presented at the subsequent Board meeting for review. The Board, however, does not have a defined meeting schedule, so the progress of grant recipients would have not been reviewed since the last meeting in January 2020.

It is also important to note that funds are paid out to grant recipients in one installment, regardless of the length of the project. The City may want to consider payment in installments based on progress reporting for longer term projects, given the size and timing of some of the grants. For example, \$250K was awarded toward the construction of a new hospice; which is a long-term project.

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## Detailed Findings

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Program successes and outcomes should be tracked and reported by the HFF Board to the GIC to demonstrate the value of the grant program and the contributions made to the residents of Hamilton. Reporting on outcome measures, however, is not currently required as part of the grant agreement. It is therefore challenging to know the positive impact of HFF funding to Hamilton residents.

Grant recipients, according to their contract, are also required to return surplus funds either not required for their project or due to the dissolution of the organization. Unused funds must be returned within two years from the date of payment. Given the infrequent or inconsistent review of progress reports, including financial information; the requirement to return unused funds may not be monitored on a timely basis. In addition, there are also no guidelines around the right to audit clause in the contract; both to ensure that funds were utilized as intended, and the anticipated outcomes per the grant application were achieved.

### Performance Reporting of Program Successes Needs Improvement

Regular performance reporting of HFF successes and challenges is important to ensure both that program goals are achieved and for the accountability of fund recipients.

According to the HFF guiding principles, "investments should achieve specific, measurable results." In addition, investments are to "provide permanent community benefit" and "improve the economic prosperity of Hamiltonians." In addition, the Board of Governors is accountable for tracking and developing performance measures both on an overall program basis and on an individual project basis.

The responsibilities of the HFF Board include:

- developing performance criteria and future investment priorities and making recommendations to Council;
- obtaining public input on future directions and priorities;
- tracking HFF performance and ensuring project benefits are completed and benefits materialize; and
- issuing an annual report on the operation of HFF (revenues, expenditures, projects initiated/completed, and investment performance).

Performance measures of activities by program, for example, such as number of roads repaired, number of individuals who benefited from hospice services, and number of meals served to at-risk youth; can demonstrate the impact of the HFF in the community. Performance reporting of funded projects can also be utilized

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## Detailed Findings

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as feedback into determining the future strategic direction and priorities of the fund based on results achieved.

The HFF Board of Governors has not provided comprehensive performance reporting on the successes and challenges of the funded projects to GIC and Council and has not issued an annual report. Overall performance criteria and future fund investment priorities have not been developed. All projects receiving funding, however, have been approved by both GIC and Council. It is an important principle of public accountability that the expenditure of government funds be shown to have public benefit, with demonstrable outcomes.

Fund A projects, such as, for example, the McMaster Medical Campus, Poverty Reduction Investment, and capital investments in roads may have outcome reporting that is not centrally received by the HFF Board of Governors, and therefore not reported to GIC, because there is no requirement to do so.

Fund B grant recipients, however, are required to provide progress reports on their projects' status to the Board of Governors, per the grant application. The progress reports content requirements include indicators for measuring the achievement of expected outcomes, however, the submission of this information is not required according to the grant contract.

Progress reports should be required and reviewed upon receipt for performance measures aligned to project objectives in the application. Progress and final reports that are received (voluntary submissions) are included as part of the Board of Governors meeting but are not summarized and forwarded to GIC and Council.

The Board of Governors reviews and approves an annual statement on the financial activity of the HFF from Finance, and an annual review of the Investment returns and activity from the Chief Investment Officer.

As there is no fund administrator and the Board meets infrequently, there has been limited work done in developing and/or reporting on performance measures for the HFF, other than the review of progress reports submitted for Fund B.

As a result, performance measures and reporting are not adequate to determine if program goals and value-for-money was achieved for the funded projects.

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## Recommendations

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Please refer to Appendix “B” to Report AUD21013 for a list of Recommendations and the related Management Response that will strengthen governance and oversight of the Hamilton Future Fund.

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## Conclusion

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The OCA has identified several opportunities for strengthening the oversight of the HFF. Strengthening the accountability framework of the HFF provides rigour and transparency to the management of funds to ensure that program objectives are achieved, therefore reducing financial and reputational risk to City.

The OCA would like to thank employees and management Corporate Services Division for their assistance in this project. We look forward to receiving the comprehensive management action plans and the improved oversight of the Hamilton Future Fund.

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