

HEDGING AUDIT (FOREIGN EXCHANGE AND FUEL)

EXECUTIVE SUMMARY

The City Auditor's Office issued the Hedging Audit (Foreign Exchange and Fuel) Report to Administration on July 8, 2016. The report includes Administration's response to six recommendations raised by the City Auditor's Office to improve the effectiveness of current hedging processes and practices. Administration accepted all recommendations and has committed to the implementation of action plans no later than October 31, 2017. The City Auditor's Office will track the implementation of these commitments as part of our on-going follow-up process.

RECOMMENDATIONS

1. That Audit Committee receive this report for information; and
2. That Audit Committee recommend that Council receive this report for information.

RECOMMENDATION OF THE AUDIT COMMITTEE, DATED 2016 JULY 21:

That Council receive Report AC2016-0606 for information.

PREVIOUS COUNCIL DIRECTION / POLICY

Bylaw 30M2004 (as amended) established the position of City Auditor and the powers, duties and functions of the position. Under the City Auditor's Office Charter, the City Auditor presents an annual risk-based audit plan to Audit Committee for approval. The City Auditor's Office 2016 Annual Audit Plan was approved on December 10, 2015. The City Auditor is accountable to Council and subject to the oversight of Audit Committee under Bylaw 48M2012 (as amended).

BACKGROUND

This audit was undertaken as part of the approved City Auditor's Office 2016 Annual Audit Plan. The objective of this audit was to evaluate the effectiveness of foreign exchange (FX) and fuel hedging processes and practices in achieving budget stability. We tested a sample of 2015 and 2016 FX and fuel hedging transactions to assess compliance with the Chief Financial Officer's Department Hedging FX Purchases Policy (FX Policy) and the Fuel Hedging Committee Calgary Transit Terms of Reference (Fuel TOR). We also benchmarked The City of Calgary's (The City's) practices with good hedging practices from three Canadian municipalities to identify opportunities to further mitigate budget uncertainty and price exposure risks.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Based on our review of good hedging practices and current City policies and practices, our view is that The City takes a conservative approach to hedging. We noted that benchmarked Canadian municipalities have established hedging policies to address aggregate exposure and utilize both physical and financial hedges. However, The City does not have a commodity hedging policy that applies to fuel, electricity and natural gas and the Fuel TOR focuses solely on physical hedges of Transit's diesel consumption. In addition, the FX Policy is prescriptive and focuses on exposure at a Purchase Order (PO) transaction level rather than on an aggregate basis and does not consider aggregate corporate exposure or forecasted cash flows for projects. We recommended a strategic review of current risk mitigation strategies that considers aggregate corporate exposure for FX and all types of fuel and includes setting risk appetite, risk

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thresholds, and risk limits with senior management approval. This review is timely given recent market volatility, and anticipated increases in investment in capital projects and energy demands.

We assessed that controls are generally effective in ensuring compliance with the FX Policy. POs are hedged according to hedging thresholds, and contracts are purchased to match the required payments in foreign currency. We raised a recommendation to define the trigger for a FX hedge and a time frame to book the hedge to ensure process consistency since the timing to book FX hedge deals is not defined in the FX Policy.

The Fuel TOR, recently implemented in March 2015, establishes a strategy to hedge Transit's diesel consumption based on budget versus market price. Overall, basic controls are in place to approve, review and place orders, and reconcile payments. However, oversight controls for fuel hedging should be strengthened since hedged diesel from October 2016 to April 2017 was not consistent with pre-determined criteria in the Fuel TOR. We raised a recommendation to implement an interim process to monitor compliance with the Fuel TOR pre-determined criteria, and a review and approval process for exceptions until such time as the fuel strategy is reviewed.

Stakeholder Engagement, Research and Communication

This audit was conducted with Treasury and Supply divisions acting as the principal audit contacts within Administration. Additional support and cooperation was provided by Transit.

Strategic Alignment

Audit reports assist Council in its oversight of the City Manager's administration and accountability for stewardship over public funds and achievement on value for money in City operations.

Social, Environmental, Economic (External)

N/A

Financial Capacity

Current and Future Operating Budget:

N/A

Current and Future Capital Budget:

N/A

Risk Assessment

The activities of the City Auditor's Office serve to promote accountability, mitigate risk, and support an effective governance structure.

Between January 1, 2015 and March 31, 2016, The City of Calgary purchased goods and services in foreign currency totaling \$65M and commodities totaling over \$157M. These types of commitments potentially expose the City to foreign currency exchange and market price volatility. Defined hedging practices can effectively mitigate price exposure providing The City improved budget certainty and protection of cash flows.

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REASONS FOR RECOMMENDATIONS:

Bylaw 48M2012 (as amended) states: "Audit Committee receives directly from the City Auditor any individual Audit Report and forwards these to Council for information."

ATTACHMENT

AC2016-0606 Hedging Audit (Foreign Exchange and Fuel)