

2014 TRIENNIAL RESERVES REVIEW REPORT

EXECUTIVE SUMMARY

This report summarizes the results of year four of the Triennial Reserve Review process performed by an Administrative Reserve Review Committee.

ADMINISTRATION RECOMMENDATION(S)

That the Priorities and Finance Committee recommends that Council:

1. Approve the changes to reserves as outlined in Attachment 1; and
2. Approve the list of reserves to be reviewed in 2015 as outlined in Attachment 3.

PREVIOUS COUNCIL DIRECTION / POLICY

The City Auditor's Office completed an audit of The City's Financial Reserves in 2009. The FCS2010-01 (AC2009-74) report dated 2010 January 18 detailed the recommendations of the audit and Administration's response and work plan to address the recommendations. One of Administration's responses was to create a Triennial Reserve Review process in which every reserve will be reviewed at least once every three years. The list of 9 reserves reviewed in 2014 was approved by Council (PFC2013-0745 Attachment 2) on 2013 December 16.

BACKGROUND

The creation, use and management of reserve funds in a formalized financial reserve policy is a best practice and consistent feature of most large cities in Canada and the United States. Reserves are part of good management that allows for funds to be spent judiciously over time or to ensure service levels are maintained and not immediately impacted by a potential downturn in the economy. Reserves provide a measure of financial flexibility to react to budget shortfalls or the financial impact of significant unexpected issues in a timely manner. A properly balanced approach to the planning and use of reserves is considered good financial management and is a key component of The City of Calgary's strong credit rating. For the majority of reserves, expenditures from and contributions to reserve funds are included in the Budget and Budget Adjustments approved by Council.

The City's reserves consist of the following:

Reserve Type	# of Reserves	Reserve Balance as of 2013 Dec 31
Operating	16	\$460 million
Capital	17	\$801 million
Sustainment	9	\$224 million
Total per Reserve Report	42	\$1,485 million

Of the \$460 million of operating reserve balance, \$365 million is held in the Fiscal Stability Reserve (FSR) as an operating contingency fund and to provide for one-time funding. Note, however, at least \$120 million of the FSR has been committed to flood related one-time projects. The majority of the capital reserves are either fully committed or have substantial commitments against them to finance existing approved projects.

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In 2010, Council approved Policy CFO013, Financial Reserves. The primary objective of the revised policy was to authorize or clarify the processes required for:

- The creation of new reserves, including the purpose, funding, conditions, restrictions and appropriate minimum/maximum funding ranges;
- Administration of reserves, including annual contributions and withdrawals, interest bearing status, the treatment of one-time or unanticipated revenue sources and courses of action if a reserve is over or under funded;
- Periodic reviews of all reserves; and
- Amendment or closure of a reserve.

Administration also developed and approved Administrative Policy FA-050, Financial Reserves, in support of the Council Policy. The Policy and associated procedures reflect best practices and provide additional guidance, procedures and responsibilities in the administration and reporting of reserves.

A significant change in Council Policy CFO013 is related to the review process of the reserves. The Policy outlines a triennial review process requiring that one third of the reserves be reviewed each year resulting in all reserves being reviewed at least once every three years.

The purpose of the Triennial Review process is to ensure that:

- i. Reserve activity meets all authorizing documents requirements;
- ii. Reserve activity is in accordance with administration reserve policies and procedures;
- iii. The reserve's purpose, conditions and/or restrictions are still relevant; and
- iv. The reserve is still required in its current form.

The review for each active reserve will cover the previous full year of operations for that reserve and shall be completed by an Administrative Reserve Review Committee comprised of:

- The Chief Financial Officer;
- Manager of Corporate Budgets, Economics, Management Analysis & Reporting (CBEMAR);
- The Corporate Finance Reporting Officer;
- A General Manager; and
- A Business Unit Director.

By the end of the year, the Administrative Reserve Review Committee will prepare a report for the Priorities and Finance Committee. The report will include the criteria used to evaluate the reserves, a summary of all findings, any applicable recommendations based upon the findings, follow up of the previous year's review recommendations if required, and a list of reserves to be reviewed during the following year.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

For 2014, Council approved the review of 9 City reserves representing a \$455 million reserves' balance as of 2013 December 31, or approximately one third of all reserves' balances.

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1.0 Initial Review

A reviewer completed a detailed review of reserve transactions and documentation of each reserve. The reviewer collected all relevant reserve documents and reviewed selected 2013 transactions in order to evaluate:

- Contributions from operations to reserves;
- Contributions from reserves to operations or capital;
- Transfers between reserves;
- Compliance of reserve activities with the reserve's mandate and all other City policies and procedures; and
- Completeness and accuracy of the disclosure of financial information in the Annual Reserve Report.

The reviewer provided findings to the Administrative Reserve Review Committee. The committee met several times throughout the year to consider the initial review results, evaluate recommendations made by the reviewer, determine whether the reserves are still relevant today, and whether they still make business sense given current Council objectives.

2.0 Review Guiding Principles

Over the years, reserves have been created for a number of reasons and with various purposes. In order to consistently evaluate various types of reserves and determine whether changes should be recommended, the Administrative Reserve Review Committee previously agreed on a number of guiding principles.

2.1 Minimize Number of open reserves

Where ever possible, the number of reserves should be reduced. The Administrative Reserve Review Committee looked to consolidate or close reserves where multiple reserves serve similar purposes and to eliminate miscellaneous and redundant reserves.

2.2 Business Categories

Currently, reserves are categorized in accounting terms as operating, capital or sustainment. However, the Administrative Reserve Review Committee also categorized reserves by business purpose such that reserves can be evaluated consistently based on the business reason for the reserve. For example, some reserves have been created to manage the timing of cash flows. Such reserves should have a reserve plan and transactions should be budgeted wherever possible, but they do not necessarily lend themselves to a target balance.

Alternatively, reserves created for contingency purposes should have a target balance. Not all transactions for these reserves can be budgeted since Administration can not anticipate a contingent event, but establishing a target balance based on an estimate of risk is appropriate. In this instance, having a consistent approach to determining an appropriate contingency amount and setting an appropriate target balance is warranted.

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Therefore, reserves created for similar business reasons should be reviewed consistently. Reserves to be reviewed in future years will also be similarly categorized and consistently evaluated.

2.3 Ongoing relevance of Reserves

The Administrative Reserve Review Committee also looked to ensure that the business reason for the reserve was still relevant and where applicable, that Administration has a plan on the strategic use of the reserve going forward and that reserve activity be budgeted where applicable.

3.0 Results of the Reviews

Over the past several years, Administration has implemented a number of control measures, such as annual checklists and documentation protocols, which have improved reserve processes and oversight.

3.1 Reserve activity meets all authorizing documents requirements

Of the nine reserves reviewed, all reserve activity met authorizing documents.

3.2 Reserve activity is in accordance with City reserve policies and procedures

All reserve activity reviewed was recorded in a timely fashion and in accordance with Council and Administrative reserve policies and Administrative reserve procedures. No issues identified with recorded reserve activity.

3.3 The reserve's purpose, conditions and/or restrictions are still relevant

All reserves reviewed are being administered as intended. However, there are instances where the reserve's purpose, condition and/or restriction can be clarified. For example, the Innovative Technology reserve's current purpose does not highlight all of the programs being funded by the reserve. Lifecycle replacement of City information technology assets are being funded by this reserve, yet that program is not clearly referenced in the reserve's current terms. Recommendation is to expand the purpose to specifically mention the programs being funded by the reserve.

Both the Reserve for Future Capital and the Lifecycle Maintenance and Upgrade reserves have evolved over time. The reserves purposes, conditions and restrictions have been modified over the years as authorizing documents are approved. The Administrative Review Committee is therefore recommending streamlining both reserve pages in the Annual Reserve Report. The recommended changes do not change the reserve terms, but rather simply restate the terms in clear language.

3.4 The reserve is still required

While performing the review, the Administrative Reserve Review Committee does question whether every reserve being reviewed is needed, or can be closed. No reserves reviewed in 2014 is recommended to be closed as all reserves reviewed do in fact provide a specific purpose which will continue to be of value going forward. However, the Administrative Reserve Review Committee is recommending changes to some reserves due to changing nature of the business. As a result of a zero-based review, Fleet Services is changing their business model such that a return on equity will no longer be required. The Administrative Reserve Review Committee is therefore recommending

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that any Fleet Services budget surplus be transferred to the reserve. Those funds can then be used to offset the cost of new assets thereby reducing the amount of debt funding required.

A very minor change to the 911 Communications Centre Capital Financing reserve is being recommended. However, future changes to the reserve may be required depending on the terms of the new agreement with the province. That agreement expected to be signed in 2015.

For the Calgary Police Services (CPS) Capital reserve, a reserve condition exists in which The Calgary Police Commission will advise Council on the disposition of funds drawn from the Calgary Police Services Pay-As-you-Go reserve. The Administrative Reserve Review Committee determined that this condition is redundant since:

- a. All CPS capital projects must be approved by Council and all CPS capital projects are included in The City's budget plans and annual budget adjustments for Council approval regardless of funding source.
- b. Council already receives regular updates on all City capital projects' spend to date of which Calgary Police Commission capital projects are included.

Therefore, creating a separate report to update Council on spending to date on only selected Calgary Police Commission projects is redundant and not required.

In addition to reviewing past reserve activity, the Administrative Reserve Review Committee continues to ensure reserves will be used strategically going forward. Where applicable, the Committee recommended to the appropriate business unit that they update their reserve plan. The plans were to include a projection of funding and expenditure dollars and ensure that reserve transactions are budgeted for accordingly.

The Real Estate Reserve was reviewed in 2012. Subsequent to that review, the Office of Land Services and Housing (OLSH) is requesting a change to the reserve's funding source. OLSH is requesting the funding source to be amended to include excess sales commissions to be contributed to the reserve. Years of high sales generates excess sales commissions which can be deferred and then distributed in years of low sales. The reserve is a sustainment reserve, both an operating and a capital reserve, thus the requested change to the funding source does fall within the current purpose of the reserve.

Please see Attachment 1 for a complete list of general comments and reserve recommendations.

Attachment 2 includes reserve summaries from the 2013 Annual Reserve Report for the reserves reviewed in 2014. Suggested changes to the text are highlighted in red.

Attachment 3 includes the list of reserves to be reviewed in 2015.

Attachment 1 and 3 require Council approval. Attachment 2 is for information purposes only.

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Stakeholder Engagement, Research and Communication

All relevant reserve leads and General Managers were informed and consulted as part of the review.

Strategic Alignment

The Triennial Reserve Review process helps The City become a more effective organization by ensuring its reserves are being managed properly and effectively.

Social, Environmental, Economic (External)

A number of reserves reviewed support social and environmental programs which assist The City in providing such services. Proper management of the reserves helps The City maintain its commitment to these social and environmental initiatives.

Financial Capacity

Current and Future Operating Budget:

In certain instances, some reserve transactions are a result of unplanned activities (for example sale of discontinued assets or use of contingency funds) and therefore cannot be budgeted. However, where reserve activities can be planned, those transactions are to be included in the operating budget.

Current and Future Capital Budget:

Where reserve activities can be planned, those transactions are to be included in the capital budget.

Risk Assessment

The Triennial Reserve Review process helps to mitigate risk by ensuring reserve balances are neither too high, where cash is held unnecessarily, or too low, where funds are insufficient to meet future needs.

REASON(S) FOR RECOMMENDATION(S):

The recommendations help to streamline administration of reserves and help clarify reserve purposes, conditions and purposes to Council and the general public.

ATTACHMENT(S)

1. Reserve comments and recommendations
2. Relevant Excerpts from the 2013 Annual Reserve Report
3. Reserves to be reviewed in 2015