

TRIENNIAL RESERVES REVIEW REPORT

EXECUTIVE SUMMARY

This report summarizes the results of year three 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;
2. Approve the list of reserves to be reviewed in 2014 as outlined in Attachment 3; and
3. Forward to the 2013 December 16 Regular Meeting of Council as and item of urgent business.

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 16 City of Calgary reserves and one joint reserve reviewed in 2013 was approved by Council in PFC2012-0606 Attachment 2 on 2012 December 17.

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 2012 Dec 31
Operating	19	\$410 million
Capital	17	\$758 million
Sustainment	8	\$215 million
Total per Reserve Report	44	\$1,383 million

Of the \$410 million of operating reserve balance, \$295 million was held in the Fiscal Stability Reserve as an operating contingency fund and to provide for one-time funding. The majority of the capital reserves are either fully committed or have substantial commitments against them to finance existing approved projects and these commitments will reduce the balances over time.

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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 2013, Council approved the review of one joint use reserve and 16 City reserves representing a \$374 million reserves' balance as of 2011 December 31, or approximately one third of all reserves' balances.

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1.0 Initial Review

A two person review team completed a detailed review of reserve transactions and documentation of each reserve. The review team collected all relevant reserve documents and reviewed 2012 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 review team provided reports of 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 review team, 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 varying types of reserves and determine whether changes should be recommended, the Administrative Reserve Review Committee 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 of value.

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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 few 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 sixteen City 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 Major Regional Facilities reserve no longer funds the planning phase of three recreation centres as those centres have now been built. Rather, that reserve is now used exclusively for artificial turf field lifecycle replacement and thus we are recommending a change to the reserve's name and purpose.

The Parks Maintenance is another reserve where the reserve is being used as intended, however modifying the reserve name and purpose makes it more clear to the reader that this reserve is an endowment reserve with specific instructions on how the funds are to be used.

The administrative reserve review committee is also recommending clarifying the Utility Sustainment purpose, condition, restrictions and funding sources. Any material change to that reserve is deferred until the results of an external consultant's cost of service report, due in 2014.

3.4 The reserve is still required in its current form

The Administrative Reserve Review Committee does question whether every reserve being reviewed is needed, or can be closed. No reserves reviewed in 2013 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 that the Unappropriated Surplus be removed from the Annual Reserve Report. The Unappropriated Surplus is the previous year's operating budget surplus, when an operating budget surplus does exist. After the financial statements are closed, the surplus is transferred to the Fiscal Stability Reserve. The Unappropriated Surplus is therefore simply a year-end temporary holding account, not a reserve.

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In the annual reserve report, the value of the previous year's surplus will be added to the Fiscal Stability Reserve table so that the reader will be aware of the value of the surplus without a page dedicated to the Unappropriated Surplus.

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

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.

Council approved report IGA2012-10, Joint Use Coordinating Committee: 2011 Status of Joint Use Reserve Fund, and requested that the Joint Use Reserve be added to the list of reserved to be reviewed as part of the Triennial Reserve Review process. Under the Joint Use Agreement, the Reserve Fund is held in trust by the Calgary Board of Education, The Calgary Catholic Separate School Board and the City of Calgary and the funds are managed by the City of Calgary Treasury as a trust account. The purpose of the Joint Use Reserve is to purchase land for schools, parks and recreation purposes where reserve land dedication is insufficient. The funds can also be used for ancillary purposes such as demolition and site rehabilitation costs when land is acquired. Funding comes from subdivision applicants who pay cash-in-lieu when they can not comply with the mandatory contribution of 10% of developable land be set aside for open space or education purposes.

The Joint User Reserve has a strong governance structure. Members representing all three parties sit on the committee and all expenditures must be approved by all three parties. Capital expenditures follow The City of Calgary's capital budget and adjustment processes and are approved by Council (included in Parks program funded by the reserve). In addition, as per IGA2012-10, Council will be provided with a status report every three years.

However, the original agreement was written in 1985 and could use an update. For example, while expenditures on ancillary expenses have been approved by all parties, the actual agreement can be more clear on the types of expenses that are eligible. Also, the agreement states that the reserve funds are to be "invested in an interest bearing account". That would be reasonable for a smaller reserve balance. However, reserve balance at end of 2012 was over \$60 million and at that level The City Treasury could generate materially more investment income than a simple savings account, while also preserving capital. The agreement is well over 25 years old, it should be updated to reflect the current environment. The Joint Use Coordinating Committee agrees with that assessment and had already begun drafting an update, even before the review began. A revised draft agreement should be available in 2014.

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 interest income on loans lent to other city business units, most notably Water Resources. The interest income received on that loan represents an unstable source of operating funding which causes continued budget variances and

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presents a challenge to effective deployment in operations. Transferring the interest income to the reserve would allow for better use of those funds.

Attachment 2 includes the list of reserves to be reviewed in 2014.

Attachment 3 includes reserve summaries from the 2012 Annual Reserve Report for the reserves reviewed in 2013. Suggested changes to the text are either black lined or highlighted in red.

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

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 to Council and the general public.

ATTACHMENT(S)

1. Reserve comments and recommendations
2. Reserves to be reviewed in 2014
3. Relevant Excerpts from the 2012 Annual Reserve Report