



STAFF REPORT INFORMATION ONLY

Implementation of Recommendations Re: 2007 Ernst & Young's Investment Compliance Audit and the Auditor General's Treasury Management Review

Date:	February 16, 2009
To:	Audit Committee
From:	Acting Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2009\Internal Services\Cf\Au09003Cf – et (AFS #8854)

SUMMARY

The purpose of this report is to outline the changes in the City's revised Investment Policy that respond to recommendations contained in the annual Investment Policy Compliance Report 2007 from Ernst & Young LLP and the Treasury Management Report issued by the Auditor General.

Financial Impact

There is no financial impact resulting from this report.

DECISION HISTORY

City Council, at its meeting held on December 1st, 2nd and 3rd, 2008, adopted the following recommendations contained in report AU9.2, 2007 Investment and Leasing Policy Compliance:

1. City Council receive the 2007 Investment Compliance Audit Report and opinion from Ernst & Young for information.
2. The City's Investment Policy be revised to address the points raised in the Ernst & Young report and be presented to Council prior to the end of 2008.

The Audit Committee requested the Acting Deputy City Manager and Chief Financial Officer to report to the first meeting of the Audit Committee in 2009, outlining the changes which are being made to the Investment and Leasing Policy.

The revised Investment Policy was approved by the Executive Committee at its meeting held on February 2nd, 2009 and will be considered by Council at its meeting to be held on February 23rd and 24th, 2009.

COMMENTS

The Capital Markets Section of the Corporate Finance Division is responsible for the prudent investment management of a number of investment portfolios. Each portfolio is specific in nature, mandate and legislative authority.

In accordance with the Council-approved investment policy, the section manages the City's funds in a manner that provides the highest investment return consistent with the maximum security of principal and maintaining liquidity to meet the City's cash needs. This strategy is applied to managing the City's cash requirements while conforming to the legislation governing the investment of City funds.

Management must incorporate both the legislative constraints and the risk profile of each portfolio. Investment policies and procedures approved by Council act as the governing guidelines for each of the individual portfolios under management.

Although specific policy limits with respect to issuer names and credit quality limits vary between the portfolios, the primary objectives, in priority order, for all City investment activities are:

1. Ensure Safety of Principal

Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the portfolios. The Corporate Finance division manages the exposure to interest rate risk through compliance with the established limits relating to the diversification of investment assets through the following measures:

- (a) Credit Rating Limitations

The policy restricts investments to highly rated fixed income securities. Equity investments are not allowed.

- (b) Issuer and Sector Exposure Limitation

The policy establishes individual issuer and sector limitations. By limiting the exposure to any one issuer or sector, overall credit and liquidity risk in a portfolio is reduced.

(c) Term Limitations

Portfolio term structure limitations must be established to ensure that the portfolio can accommodate future cash requirements. Each portfolio has a term requirement that may be dictated by legislation or determined by the specific characteristics of the portfolio itself. Term limitations have been established to restrict the term exposure for particular issuers.

2. Maintain Adequate Liquidity

Liquidity refers to the ease with which a security can be converted into cash. Maintaining adequate liquidity helps to ensure that excess funds are invested until they are needed and enables the City to meet all operating requirements that might be reasonably anticipated. The drawback to this policy is the inverse relationship between liquidity and return. The more liquid the security, generally, the lower the investment return.

3. Maximize Rate of Return while Conforming to Other Objectives

The objectives of safety of principal and maintenance of liquidity must not be compromised in order to maximize returns. Once the essential parameters governed by the first two objectives have been addressed, the Corporate Finance Division manages the portfolio in such a way to maximize its longer-term income flow.

For 2007, the Ontario Municipal Benchmarking Initiative (OMBI) reported that the City earned a rate of return of 5.28% on its investment portfolio which, for the second year since inception of such reporting, was the highest rate as reported by the municipalities who participated in the measurement process.

Until the revised Investment Policy is implemented on February 28th, 2009 after being approved by Council, staff expects that the City will not be fully compliant in the 2008 audit due to some minor variances such as a term extension of a couple of provincial government bonds which does not constitute addition risk to the portfolio. The results of that audit will be reported to the Audit Committee in the spring 2009.

The revised investment policy addresses all of the issues and concerns that were noted in both the Auditor General's Treasury Management Review and Ernst & Young's 2007 Investment Compliance Audit as considered by the Audit Committee at the meeting held on November 4, 2008:

Implementing Audit Recommendations contained in the Auditor General's Treasury Management Review:

- establishes clear guidelines as well as a formal process, timelines and protocols for identifying, communicating and acting upon policy exceptions to ensure City holdings are in compliance with investment policies;
- ensures that City holdings are reviewed regularly for such exceptions and evidence of such review will be documented;
- includes a policy dealing with technical trading which is defined as identifying transactions that take advantage of market inefficiencies by trading securities on a short-term basis;
- establishes clear roles and responsibilities of Capital Markets' staff and senior management and outlines the documentation and management approval requirements of any action related to policy exceptions;
- defines the duties, roles and functions of Capital Market's staff and stipulates trader authority limits;
- includes a code of ethics and standards of practice statements specific to the Capital Markets area so as to provide guidance relating to personal trading, gifts, offerings, trader ethics and trader relationships with brokers and investment dealers, including disclosure requirements, using the Chartered Financial Analysts Society's ethics policy (the financial industry's standard) as a guide;
- Sets limits on concentrations in volume and dollar amounts.

Appendix A contains a chart that tracks the audit recommendations to the applicable sections of the Investment Policy.

Issues arising from Ernst & Young's 2007 Investment Compliance Audit that are addressed in the revised Investment Policy:

- ensure consistency in the asset classifications and the holding limits established in the internal Investment System and the Investment Policy,
- E&Y stated that the City was not materially in compliance with the investment policy in 2007, they did not indicate that the City had any material problems with the investment portfolio as it did not include any impaired assets such as asset-backed commercial paper (ABCP).

In effect, their audit noted some exceptions to strict adherence to the Council-approved investment policy which were relatively minor such as a \$5 million holding in the Province of Saskatchewan's bonds that have a maturity of 32 years whereas the investment policy stipulates a 30 year term limit and an exposure of 26.13% as compared to a limit of 25% of the portfolio for Province of Ontario bonds.

These exceptions have been addressed by staff as well as on a go-forward basis in the revised investment policy which as recently approved by the Executive Committee.

The City's investment policies and procedures are continuously monitored to ensure that the approved policy achieves the objectives of the respective investment portfolios and the audit compliance items.

On an annual basis, and more frequently if required, a comprehensive review is completed by staff and recommended adjustments are incorporated into the City's Investment Policy and presented to Council for approval.

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SIGNATURE

Cam Weldon
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ATTACHMENT

Appendix A: Implementation of Audit Recommendations

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Audit Recommendations No.	Recommendations from the Auditor General's Treasury Management Review	Investment Policy Section and Page No. as approved by the Executive Committee at its meeting on February 2, 2009
003	Investment Policies should include clear guidelines, timelines and protocols for identifying, communicating and acting upon policy exceptions. The guidelines should include clear roles and responsibilities of Capital Markets Staff and senior management and should outline documentation and approval requirements of any action related to the exceptions.	Section 2.10 – Compliance Reporting Page 21 Section 2.8 – Roles and Responsibilities in Investment Functions Page 17 Section 2.9 – Trader Authority Limits and Trade Authorization Page 21
004	There should be a formal review process for reports to be developed, documented and implemented. All available reports, with special emphasis on exception reports, should be reviewed and consulted regularly to ensure City holdings are in compliance with Investment Policies. Evidence of such review is documented.	Section 2.10 – Compliance Reporting Page 21
006	The Investment Policy will need to include the appropriateness of technical trading and address technical trading in the Investment Policies	Section 2.7 – Investment Management Style Page 17
011	The Investment Policy should include the ongoing duties, roles and functions of Capital Markets staff and trader authority limits. The duties of incumbents in the Capital Markets area should correspond with their respective job descriptions and align with assigned signing authorities	Section 2.8 – Roles and Responsibilities in Investment Functions Page 17 - 20 Section 2.9 – Trader Authority Limits and Trade Authorization Page 21 Note: The table of signing authorities will be included in the Procedure document as recommended by DCM/CFO

Audit Recommendations No.	Recommendations from the Auditor General's Treasury Management Review	Investment Policy Section and Page No. as approved by the Executive Committee at its meeting on February 2, 2009
012	The Investment Policy should include ethics policies and statements specific to the Capital Markets area. Policies and statements should include guidance relating to personal trading, gifts, offerings, trader ethics and trader relationships with brokers, as well as requirements for reporting deviations from policy to senior management. Acknowledgement statements should be updated and signed by all Capital Markets staff on an annual basis	Section 3 – Standards of Professional Conduct Guidelines Page 24 – 29 Note: Annual acknowledgement statements will be included in the Procedure document as recommended by DCM/CFO.
013	The new Investment Policy should establish limits on concentrations in volume and dollar amounts; concentrations over the set amounts should be explained, documented and reviewed by senior Capital Markets staff.	Section 8 – Approved list of issuers and corresponding term and exposure limits Page 39-46. Section 2.10 – Compliance Reporting Page 21