

Review of Reserves and Reserve Funds

The Audit Committee recommends the adoption of the following report (November 29, 1999) from the City Auditor:

Purpose:

To report on the results of the Audit Services' review of the City's reserves and reserve funds.

Recommended:

It is recommended that:

- (1) the Chief Financial Officer and Treasurer provide Council with reserve and reserve fund continuity schedules on a semi-annual basis, itemizing contributions to and withdrawals from each reserve and reserve fund;
- (2) the pending report to Council regarding the consolidation, continuance and creation of reserves and reserve funds, clearly identify any changes in the report adopted by Council on April 29 and 30, 1998, and the corrective action taken. Consultation with applicable user departments should also occur prior to finalization of the report;
- (3) the Chief Financial Officer and Treasurer ensure that the accounting for reserves and reserve funds be brought up to date by December 31, 1999 and that senior management ensure that this accounting is done on a regular basis in the future;
- (4) the Chief Financial Officer and Treasurer ensure that interest is applied to reserve funds on a monthly basis and that the Accounting Services Division provide Treasury and Financial Services staff with the total amount of interest applied;
- (5) the Chief Financial Officer and Treasurer develop by January 1, 2000, appropriate accounting policies and procedures relating to reserves and reserve funds, ensure that proper controls exist to monitor these accounts and that management information is complete, accurate and up-to-date;
- (6) the Chief Financial Officer and Treasurer confirm the roles and responsibilities of the various divisions within the Finance Department with respect to reserves and reserve funds and ensure that all applicable Finance staff are apprised accordingly; and
- (7) **the Chief Financial Officer and Treasurer clearly advise user departments regarding their roles and responsibilities with respect to reserves and reserve funds and ensure that departments are provided information relating to specific accounts, as requested.**

Background:

The City of Toronto, as at December 31, 1998, maintains reserves of \$286 million and reserve funds totalling \$1.134 billion. Details of reserves and reserve funds are included in Appendix I of this report.

Reserves and reserve funds have designated purposes and are created through the specific authorization of Council for its own purposes or as required by provincial legislation. The Municipal Act, section 367(3), is the authority for the creation of a reserve. Section 163(2) of the Act permits the establishment and maintenance of reserve funds. This section also provides that the auditor in the annual report shall report on the activities and position of each reserve fund. The authorities and other responsibilities pertaining to reserves and reserve funds will be provided for in the new Financial Control by-law to be submitted to Council later this year.

A reserve is an allocation in the current budget or an allocation of accumulated net revenue set aside for a specific purpose; it has no reference to any specific asset. A reserve fund has distinguishable assets and monies that are set aside in separate bank accounts. Income earned on reserve fund investments is accounted for as part of the reserve fund.

Comments:

As part of the 1999 Audit Workplan, a review of the City's reserves and reserve funds has been completed.

The review focused on the following areas:

- issues surrounding establishment and use of reserves and reserve funds as well as the consolidation of these funds;
- issues surrounding the adequacy of reporting relating to reserve and reserve funds;
- procedures, processes and internal controls surrounding the accounting for reserves and reserve funds;
- clarity of roles and responsibilities, relating to reserves and reserve funds, within the Corporation; and
- adequacy of information available for user departments as well as for the Finance Department.

The review included interviews with Finance and Legal staff, as well as discussions with user department staff. An examination and analysis of available documentation was also performed. A review of the appropriateness and consistency of expenditures, to determine whether the expenditures were within the funds' stated purposes, could not be conducted since the majority of transactions for 1999 had not been recorded in any of the accounting systems. A follow-up review of reserves and reserve funds will be undertaken as part of our 2000 work plan and will address any outstanding issues.

Many of the issues contained in this report have been identified as concerns by the Chief Financial Officer and Treasurer and are currently being addressed. Additional resources have been allocated to ensure that the accounting for reserves and reserve funds is brought up to date.

Our findings and recommendations are provided below.

Reporting

The Chief Financial Officer and Treasurer is currently preparing a report to be submitted to the Policy and Finance Committee on the management of reserves and reserve funds.

We understand that included in this report is a recommendation that:

“The Chief Financial Officer and Treasurer should be authorized to make contributions to any tax supported reserve, where it is not contrary to the law.”

In the absence of specific financial limits to the Chief Financial Officer and Treasurer's authority for transactions relating to reserves and reserve funds, it would be appropriate that a formal process of reporting to Council be established to ensure that Council is aware of the activity in these accounts. Continuity schedules of reserves and reserve funds should therefore be provided to Council on a semi-annual basis. These continuity schedules should be reviewed by senior management and provide Council with information on specific contributions to and withdrawals from the various reserves and reserve funds as well as up-to-date balances in each account.

Recommendation:

- 1. The Chief Financial Officer and Treasurer provide Council with Reserve and Reserve Fund continuity schedules on a semi-annual basis, itemizing contributions to and withdrawals from each reserve and reserve fund.**

Management Response:

Finance is planning to present in January 2000 the continuity schedules for 1998 and 1999 as well as proposed budgets for contributions and withdrawals for 2000. The budget estimates for reserve and reserve funds are not easy to make with any certainty and as such, it is more appropriate to submit the estimates annually as part of the budget process and to report progress in the September variance report.

Consolidation of Reserves and Reserve Funds

A report addressing the consolidation and establishment of reserves and reserve funds was adopted by Council, with amendments, at its meeting on April 29 and 30, 1998. This report recommended, among other items, the consolidation of existing reserves and reserve funds according to an attached schedule. Finance staff have been working with Legal Services since

the adoption of the report to prepare a by-law that provides for the consolidation, continuance and creation of reserves and reserve funds. The draft by-law is nearing completion and a report will be submitted to Council accordingly.

We note that the April 1998 report adopted by Council incorrectly consolidated the reserve funds relating to the Waterworks and Waste Water reserve funds. In addition, there continues to be differences of opinion with the Legal Department as to the nature of certain revenue funds. The Finance and Legal Departments are currently working to resolve this issue.

In addition, there are departmental concerns surrounding the consolidation of certain reserves and reserve funds. These relate to the continued existence of reserves and reserve funds and their availability to meet previous commitments and decisions. This lack of information has created a general uncertainty among user department staff.

Recommendation:

2. **The pending report to Council regarding the consolidation, continuance and creation of reserves and reserve funds, clearly identify any changes in the report adopted by Council on April 29 and 30, 1998, and the corrective action taken. Consultation with applicable user departments should also occur prior to finalization of the report.**

Management Response:

The April 1998 report presented a preliminary consolidation of the major corporate reserves and reserve funds such as working capital, sick pay, employee benefits and land acquisition. One of the recommendations in that report was that a further report be prepared which established a by-law giving effect to the consolidation or continuance of reserve funds included in the report. This will be submitted to the January 2000 meeting of the Policy and Finance Committee. Some minor reallocations from those listed in the April 1998 report will be included in the report as well as accounts created since that time.

The April 1998 report did not differentiate the Water reserve funds between Water and Sewer and reflected certain reserve funds in the manner that they were previously reported in the former municipalities. This will be corrected in the January 2000 report.

The pending report to Council regarding the consolidation, continuance and creation of reserves and reserve funds has been reviewed with the Legal Department and will be reviewed by Departments and will replace the earlier report in its entirety rather than augment the earlier report.

Accounting for Reserves and Reserve Funds

The Accounting Services Division within the Finance Department is responsible for the recording of all accounting transactions relating to reserves and reserve funds. This division is also responsible for responding to user department queries relating to these accounts.

Accounting policies and procedures for reserves and reserve funds are currently being prepared but have not yet been forward by Finance Department staff. Consequently, there appears to be minimal control procedures in place to monitor these accounts.

At the time of our review in mid-October 1999, surpluses for the prior year had not been recorded in the accounts. In addition, 1999 interest relating to the reserve funds had not been recorded and minimal transactions were available for review. Even though Council has authorized various commitments related to reserves and reserve funds, many of these commitments had not been accounted for at the time of our review. The fact that the reserves and reserve funds were maintained on four separate accounting systems and that staff was not specifically assigned to the task of ensuring all transactions relating to these accounts were recorded, further complicated matters.

The problems outlined above have resulted in a lack of accurate and up-to-date management information throughout 1999 which directly impacts as:

- the ability to determine the adequacy of balances in the reserves and reserve funds;
- the ability to properly account for in year variances relating to interest income provided for in the operating budget; and
- the ability of user departments to determine the capital funding availability for future projects.

In order to obtain necessary information, the Treasury and Financial Services Division dedicated over four months of staff time to track and estimate the commitments, contributions and expenditures that affect reserves and reserve funds. This task was complicated by the lack of staff continuity in the various program areas as well as a lack of accounting staff knowledgeable in the former accounting systems. Some of the problems identified by the Treasury and Finance Division are noted below:

- Contributions relating to one fund were recorded in one accounting system while the expenditures related to the same fund were recorded in another system;
- Transactions belonging to one fund were erroneously recorded in other funds, making reconciliation of balances problematic; and
- Adjusting entries to the 1998 financial statements were not posted to the applicable general ledgers.

The lack of accounting for reserves and reserve funds on an on-going basis not only impacts on the completeness and timeliness of management information but also places additional strain on Finance staff at year end.

Recommendations:

3. **The Chief Financial Officer and Treasurer ensure that the accounting for reserves and reserve funds be brought up to date by December 31, 1999 and that senior management ensure that this accounting is done on a regular basis in the future.**

Management Response:

The Accounting Division is in the process of ensuring that all amounts budgeted for transfer to or from reserve funds are recorded in the general ledger. This will be completed by December 31, 1999. All other transactions have been recorded as they have occurred. During 1998 and through to August 1999 there were four financial systems in operations. Where possible, the Finance Department attempted to record transactions in one system based on the consolidation of reserve funds. This included year end adjustments. Reserves and reserve funds were maintained in the four remaining accounting systems because they were tied to the operating budget and capital funds still active and it was considered appropriate to continue the operation of certain reserve and reserve funds in certain systems until all systems were amalgamated to one in August.

The following reserve and reserve funds transactions have been processed at this time:

- All 1998 year end adjustments affecting reserve funds have been processed.
- Entries funding 1999 capital projects from reserve were previously completed prior to the end of September.
- Interest allocations to reserve funds are completed for the month of September. October allocations are being processed this week. Allocations for November and future months will be processed at the beginning of the following month.
- Cost centres have been established to allow us to process disbursements previously charged directly against various reserve funds. Expenditures in these cost centres are being fully funded from the related reserve fund in early December. While these entries are being processed at the end of each month, there will be some disbursements posted to these cost centres on the last day or so of a month that will not be funded until the following month.

4. The Chief Financial Officer and Treasurer ensure that interest is applied to reserve funds on a monthly basis and that the Accounting Services Division provide Treasury and Financial Services staff with the total amount of interest applied.

Management Response:

This has been completed to October 31, 1999 and will be done on a monthly basis, one month in arrears since the month end balance needs to be finalized prior to calculating the interest earnings.

5. **The Chief Financial Officer and Treasurer develop by January 1, 2000, appropriate accounting policies and procedures relating to reserves and reserve funds, ensure that proper controls exist to monitor these accounts and that management information is complete, accurate and up-to-date.**

Management Response:

As at December 1, 1999 draft documents are being reviewed and discussed with senior management in preparation for the January 2000 Policy & Finance Committee.

Roles and Responsibilities Within the Finance Department

The establishment of, dissemination of, and accounting for information relating to reserves and reserve funds impact various divisions within the Finance Department, as well as user departments. As such, it is important that the roles and responsibilities of each division be clearly defined and understood by all staff to avoid duplication of effort. We understand that the Finance Department has developed roles and responsibilities for each of the divisions within the department. However, our discussions with staff in these divisions indicate that some staff are still unclear about their specific roles. Based on discussions with staff in user departments, it would appear that departments are also unclear as to their roles and responsibilities.

Management Response:

Recommendation:

6. **The Chief Financial Officer and Treasurer confirm the roles and responsibilities of the various divisions within the Finance Department with respect to reserves and reserve funds and ensure that all applicable Finance staff are apprised accordingly.**

Management Response:

In June 1999 a memorandum was prepared by the affected Finance directors clearly defining the roles and responsibilities of the various divisions within the Finance Department. This will be reaffirmed by the Directors in Finance.

7. **The Chief Financial Officer and Treasurer clearly advise user departments regarding their roles and responsibilities with respect to reserves and reserve funds and ensure that departments are provided information relating to specific accounts, as requested.**

This will be incorporated in the January 2000 report to Policy & Finance Committee.

Conclusions:

The City of Toronto reserves and reserve funds are significant in value and were reported as at December 31, 1998 at a total value of \$1.4 billion. It is therefore imperative that the accounting related to these reserves and reserve funds be complete, accurate and up to date and that Council be apprised of the activity in these funds on a regular basis. Failure to have reliable information could have an adverse impact on the decisions made by the Finance Department, user departments and Council.

Significant problems noted in our review include:

- failure to record the majority of 1999 transactions as well as adjustments pertaining to the previous year;
- lack of proper procedures to monitor reserve and reserve fund accounts;
- lack of accurate and up to date management information; and
- lack of documented policies and accounting resources dedicated to the accounting for reserves and reserve funds.

Corrective action relating to the above issues is currently taking place on a priority basis. Based on our discussions with the Chief Financial Officer and Treasurer, it is the intent that all accounting records relating to reserves and reserve funds be brought up to date by December 31, 1999.

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Appendix I

Reserves And Reserve Funds

	1998	1997
Reserves	\$000	\$000
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Set aside for specific purposes by Council		
Water rate stabilization	93,902	
	88,933	

Working capital	82,218
	82,218
Vehicle and equipment replacement	74,875
	81,711
Winter control stabilization	16,771
	271
Homes for the Aged	6,482

Licence fee stabilization	---
	4,935
Contingency	3,902
	3,736
Waste management	2,472
	5,022
Police central sick pay	1,690
	1,869
North York Performing Arts Centre stabilization	1,545
	1,545
Road enhancement	1,345
	168
Miscellaneous	300
	259
Total Reserves	285,502
	270,667

Reserve Funds	1998
	1997
	\$000
Set aside for specific purposes by Council	
Employee related	

Employee benefits	151,542
	128,534
Sick leave	89,713
Workplace Safety & Insurance	17,545
15,553	
Productivity improvement	1,924
	2,169
Workforce reduction	- - -
	11,100
Capital expenditure	
Transit	7,620
	464,820
Parking	44,906
52,542	
Land acquisition	25,259
52,081	
Solid waste management	19,334
	14,418
Capital levy	19,269
21,744	
Water	12,277
12,811	
TEDCO environmental remediation	11,375
10,773	
Capital financing	10,878
11,390	
General government	5,003
4,995	
Exhibition Stadium capital	3,443
4,017	

Building maintenance	3,232
3,193	
Other	
Social and family services	28,695
3,213	
General government	7,233
103	
Economic development, culture and tourism	4,173
2,798	4,037
Urban planning	2,944
Election	1,967
	319
Insurance	41,836
41,195	
TTC stabilization	1,203

Hummingbird stabilization	804
687	
Zoo stabilization	<u>630</u>
<u>630</u>	
	<u>970,005</u>
	<u>472,951</u>

	1998
	\$000
Set aside for specific purpose by legislation, regulation or agreement	1997
	\$000
Development levies	57,908
44,992	
Water pollution control	43,888
	78,747

Subdividers' deposits	25,945
	24,211
Parkland acquisitions	23,849
	27,917
Third party agreements	11,654
	8,836
Donated funds	<u>613</u>
	<u>654</u>
	163,857
Total Reserve Funds	<u>1,133,862</u>
	<u>658,308</u>