

Appendix D – Accounting Overview of Obligatory Reserve Funds, Reserves and Discretionary Reserve Funds

Obligatory Reserve Funds

Obligatory reserve funds are normally created when cash payments are received from third parties that obligate the City to make an investment or settle an obligation in the future. Cash received from these third parties is deposited in the City's bank accounts and a obligatory reserve fund balance is established in accordance with Toronto Municipal Code Chapter 227 as a liability in the City's financial records until the obligation is satisfied or as required investments are made. Obligatory reserve funds are a subset of deferred revenues. Obligatory reserve funds can also be created for some payments received over time like deferred development charges, which have similar obligations.

The City's obligatory reserve funds are accumulated from various advance payments, including amounts received from legislated development payments for growth-related infrastructure, government grants that restrict use of funds for specific programs like transit or housing, and third-party agreements that outline how funds are expected to support future investments or the cost of operating programs. Advance payments can also be received from customers who use City services, such as advance payment for rent of City event spaces or City facilities.

The obligatory reserve fund balances are not reserves; the amounts are liabilities that obligate the City to complete an action committed to a third party for which the monies are received. Obligatory reserve funds are considered liabilities because the amounts must be returned to the third party, if the good, service or investment is not delivered as planned. Obligatory reserve funds are included in the deferred revenue liabilities balance on the City's Statement of Financial Position.

When these payments are received, they are considered contributions to the obligatory reserve fund balance. When the good, service or investment for which the funds were intended is delivered, they are recognized as earned revenue in the City's Statement of Operations and Accumulated Surplus. It is only when the conditions for use of the funds are met, that the obligatory reserve fund is recognized as earned revenue in the City's financial results.

The timing of earned revenue from obligatory reserve fund balances depend on the type and complexity of performance obligations or stipulations in third party agreements that need to be met. As an example, development charges governed by Provincial legislation make up a significant portion of the City's obligatory reserve fund balance. The amounts paid by developers are recorded as obligatory reserve fund contributions when building permits are issued, but recognition of these amounts into the City's earned revenues is tied to capital infrastructure planning and execution activities that transcend several years. Similarly, obligatory reserve fund contributions from third party agreements may require that the City execute on obligations over a number of fiscal years; earned revenue would only be recognized in the future as the expenditures incurred to execute on those obligations are also recognized.

Certain agreements, contracts or legislation require that interest be allocated to obligatory reserve fund contributions. These interest allocations are recorded as contributions to the individual balances in the fourth quarter of the fiscal year, increasing the value available to be recognized as earned revenue in future years.

Reserves and Discretionary Reserve Funds

Reserves and Discretionary Reserve Funds represent an allocation of the City's annual budget surplus and comprise a component of the accumulated surplus balance in the City's consolidated financial statements. These balances have accumulated over time from net surpluses or specific contributions and are set aside for specific purposes as directed by Council, such as the replacement of capital infrastructure or funding of ongoing program costs. They also provide a measure of financial flexibility to react to or address the immediate financial impact of significant unexpected pressures.

Reserves and Discretionary Reserve Funds are allocations of balances; contributions and/or draws do not represent revenues and/or expenses on the City's Consolidated Statement of Operations and Accumulated Surplus. These balances are accumulated as a result of net surpluses that have already factored in recognized revenues and incurred expenses. In addition, the balances in this report do not include Deferred Revenues, which are contributions recognized on the City's Consolidated Statement of Financial Position that have specific performance obligations or stipulations that must be executed before revenues can be earned.

Reserves and Discretionary Reserve Funds are drawn upon to finance operating and capital expenditures as designated by Council; the contributions to, or draws from, Reserve and Discretionary Reserve Funds represent a source or use of funds. Contributions to Reserves and Discretionary Reserve Funds are not revenue earned by the City; similarly, draws are not expenses. Total Reserve and Discretionary Reserve Funds are consolidated within the City's Accumulated Surplus position on the Consolidated Statement of Financial Position. Outside of planned reserve contributions for specific uses, when possible, contributions may be made when there are excess cash inflows over budgeted amounts, when there are lower expenditures than budgeted or when there are timing impacts to commitments originally planned and approved.