



City of Edmonton Office of the City Auditor

Reserve Funds Governance and Management Review

November 10, 2021



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Report Summary

Background

Reserve funds represent a source of funding of accumulated surplus amounts that the City has restricted for specific requirements or made for emergent financial needs. The City has 37 reserve funds that have a combined value of \$889 million as at December 31, 2020. The City uses guiding documents, such as bylaws, city policies and external agreements, to support the management of each reserve fund.

To fund an expense from a reserve fund, operational areas must have an approved budget to use the reserve fund and that the expense is an allowable use of the reserve fund. The Financial Services Branch (Finance) is responsible for reviewing the overall expenses and transferring funds from a reserve to offset the expense. Individual expenses and invoices are governed by the Expenditure Accountability Framework Administrative Procedure to make sure they are inline with approved budget and program objectives.

Audit objectives¹

To determine whether:

1. A governance framework is in place to ensure that the City is using reserve funds for their intended purposes.
2. The City is properly managing the use of reserve funds.

What we found

The essential components of an effective governing framework for the administration and proper use of reserve funds exists. Finance defined roles and responsibilities, performed a review of reserve funds every three years, and reported regularly to Council on reserve fund activities. Operational areas also assessed the sufficiency of reserve funds regularly using forecasts and sensitivity analyses, industry stakeholder consultation, and monthly reviews of reserve fund activity.

Finance has also developed a reserve fund governing document which provides guidance on the definition and types of reserve funds. However, this document does not cover some elements that good practice suggests including what are allowable and non-allowable uses of reserve funds.

¹ We conducted this engagement in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. Please see Appendix 1 for the audit scope discussion.

Each reserve fund also has a fund-specific guiding document that Finance and the operational areas use to support the management of the reserve fund. Some of these documents describe what are allowable and non-allowable uses of their reserve fund. Where there is a good description of an allowable use, the expenses we reviewed were properly funded from the reserve fund. However, when the descriptions are not clear we had to review additional documents and use judgement to determine if the expense aligned with the purpose of the fund. We found most expenses generally did and a few that did not.

Recommendation

Recommendation 1

We recommend Finance update its governing document to promote the consistent administration and use of reserve funds.

Why this is important

Policy provisions that promote consistent administration of reserve funds support the proper use of reserve funds. In particular, guidance on allowable and non-allowable uses support operational areas in using reserve funds for their intended purposes.



Background

Reserve funds

Reserve funds are accumulated amounts from surpluses and specific revenue sources that are restricted by the City for specific requirements or to stabilize variations in program revenues and expenses. Reserves represent a source of funding that operational areas can use after seeking approval from Council.

As at December 31, 2020, the City's reserve balances totaled \$889 million held within the following types of reserves:

Stabilization Reserves - are used to minimize impacts on service delivery and the general tax-levy by accommodating fluctuations in program revenue and expenses for operations that are intended to be self-sustaining.

Specific Purpose Reserves - are used to fund one-time or specific projects or initiatives.

Regulatory / Third Party Requirements Reserves - are used to allocate funds required to meet obligations associated with third party agreements, legislation, and regulation.

Appendix 2 lists the City's reserve funds as at December 31, 2020.

Reserve fund governance

City Policy and Procedure *C217D Reserve and Equity Accounts* govern reserve funds and equity accounts. They describe the purpose and types of reserve funds. They also establish the roles and responsibilities for reserve fund management by clarifying that the City Manager brings transfers to and from reserve funds to Council for approval via the City's budget process. It further details that the Chief Financial Officer will undertake a detailed review of reserve fund requirements every three years.

Reserve fund administration

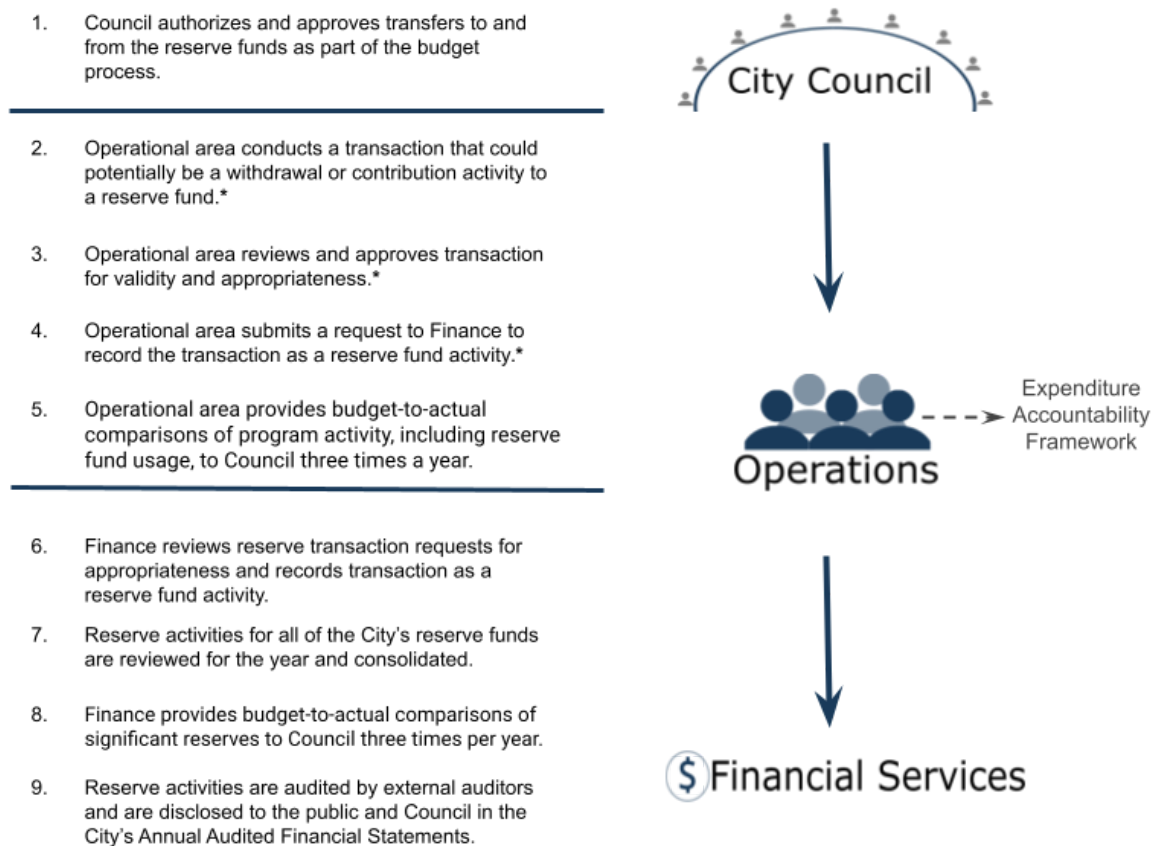
Each reserve fund also has fund-specific guidance that Finance and the operational areas use to support the management of the reserve fund. Depending on the nature of the reserve fund, this guidance comes from several different types of documents

ranging from Provincial legislation, bylaws, City policies, external agreements, and Council reports.

Reserve fund transaction process

Figure 1 illustrates the reserve funds' transaction process. All expenditures are governed by the Expenditure Accountability Framework². To fund an expense from a reserve fund, operational areas are responsible for authorizing expenditures, ensuring there are sufficient funds available within the approved budget, and that the expense is an allowable use of the reserve fund. Finance is responsible for reviewing the expense and recording it as a charge to the reserve fund. Finance also reports the results of reserve fund activity to the public via the City's audited financial statements.

Figure 1: City of Edmonton Reserve Funds Transaction Process



* Every expense in the City is governed by the *Expenditure Accountability Framework Administrative Procedure* including reserve fund expenses. Operational areas are required to follow it when approving expenses ensuring they are inline with approved budget and program objectives.

² The Expenditure Accountability Framework prescribes the roles of City employees accountable for financial transactions, and the limits applicable to each role. It also prescribes payment approval of City money.



Updating the Governing Document

Key findings

Finance developed a governing document for reserve fund management for all reserves called *City Policy C217D Reserves and Equity Accounts* (governing document). This document defines the types of reserve funds and establishes roles and responsibilities. However, this document does not cover some elements that good practice suggests, including what are allowable and non-allowable uses of reserve funds.

Each reserve fund also has a fund-specific guiding document that Finance and the operational areas use to support the management of the reserve fund. Some of these documents describe what are allowable and non-allowable uses of their reserve fund. We found where there is a good description of what is an allowable use, the expenses we reviewed were properly funded from the reserve fund. However, when the descriptions are not clear we had to use additional documents and judgement to determine if the expense aligned with the purpose of the fund. We found most generally did and a few that did not.

Governing documents

The governing document defines the types of reserve funds and the roles and responsibilities for reserve fund management in the City. However, the following policy provisions, when compared to other practices³, are not included in the governing documents and are important for the following reasons:

- **Defining allowable and non-allowable uses** of reserve funds support the proper use of reserve funds by operational areas,
- **Where applicable, quantitative thresholds and targets** set boundaries for reserve fund spending by operational areas, and
- **Monitoring, recording, and reporting requirements** facilitate the assessment of reserve fund activity by Finance and operational areas.

³ Comparisons of the City's Reserve Fund Policy were made to reserve policy guidance and information provided from the following sources: 1) Government Officers Finance Association Alberta- *Reserve Policy Template* , 2) Governmental Accounting Standards Board - *Statement No. 54*, 3) KPMG - *City of Oshawa Reserves Policy Audit*, and 4) Rural Municipalities of Alberta - *Understanding Financial Reserves*.

Individual reserve fund guiding documents

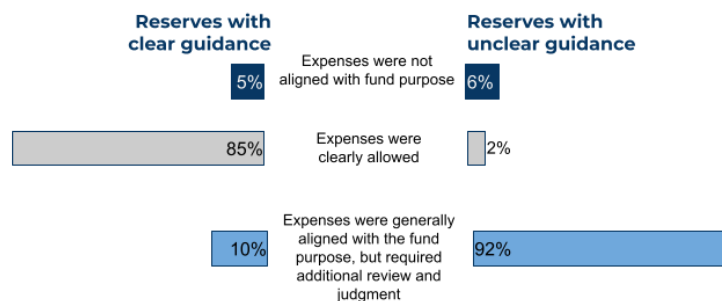
Policy provisions that promote consistent administration of reserve funds support their proper use. They also enhance the effectiveness of the governing framework for reserve fund management.

Each reserve fund has a fund-specific guiding document that Finance and the operational areas use to support the management of the reserve fund. However, the guiding documents do not all define what an allowable use of the reserve fund should be. Out of the 33 reserve funds we reviewed, 15 did not have clear guidance on the allowable uses within the guiding document and we had to look for additional information (supplementary documentation).

We found that where there is a good description of an allowable use, the majority of expenses were a proper use of the reserve fund.

Where the guiding documents were not clear on allowable uses, we reviewed supplementary documentation from past Triennial Reserve Review reports (Reserve Fund Summary), budget documents, and Council reports to understand and form a judgement of whether the expense was in alignment with the purpose of the reserve fund. We found that the majority of the expenses that were not clearly defined as allowable uses, were in alignment with the purpose of the reserve fund.

Comparison of Reserve Funds with Clear and Unclear Guidance on Allowable Uses



The Reserve Fund Summary document was particularly useful in clarifying the allowable uses. This document is provided to Council every three years as part of Finance's triennial review of reserve funds. It provides updates on new reserve funds, reserve funds slated for closure, and provides information on the purpose, allowable uses, and the guiding documents for each reserve fund. Operational areas, however, are not aware of this document as a source of reserve fund management




guidance. The guidance from this document can inform operational areas of allowable uses, thus reducing interpretation of what a reserve fund can and cannot be used for.

To supplement fund-specific guiding documents and bring further clarity, Finance intends to include a discussion about allowable uses of reserve funds in its governing document. This discussion will include a reference to the Reserve Fund Summary for operational areas to review. Providing this clarity to operational areas supports the use of reserve funds for their intended purposes.

Why this is important

Guidance on allowable and non-allowable uses of reserve funds clarifies to operational areas what reserve funds can and cannot be used for. This supports the proper management and consistent administration of reserve funds in the City.

Recommendation 1

	Update the governing document to promote the consistent administration and use of reserve funds.
	Responsible Party Branch Manager, Financial Services
	Accepted by Management
	Management Response Management accepts the recommendation. To address this recommendation the Branch Manager of Financial Services will redesign the governing documents, guidance documents and supplementary documents so there is a cohesive framework of connected guidance that will enhance transparency for business areas eligible for funding from reserve accounts. In this update we will incorporate the more detailed information that is currently included in the supplementary documentation within the City's policy framework.
	Implementation Date September 30, 2022

Acknowledgement

We would like to thank the staff in the Financial Services Branch and management from the operational areas responsible for the 33 reserve funds reviewed, for sharing their knowledge and time throughout the review. It was greatly appreciated.

Appendix 1 - Audit Scope

Audit Scope

The scope of this audit included all of the information and activities related to the City of Edmonton's reserve funds from January 1, 2019 to December 31, 2020. The following reserve funds were excluded from the review:

- Edmonton Police Service
- Edmonton Police Services Pay-As-You-Go Capital Reserve Fund
- Fort Edmonton Train Maintenance
- Sanitary Servicing Strategy Fund

Additionally, the audit did not review the governance and management of the City's equity accounts which are also discussed in City Policy C21D *Reserve and Equity Accounts*.

Appendix 2 - City of Edmonton Reserve Funds

Stabilization Reserves

- 1 Financial Stabilization Reserve
- 2 Perpetual Care Reserve
- 3 Planning and Development Reserve
- 4 Tax Supported Reserve
- 5 Tree Maintenance Reserve
- 6 Vehicle for Hire Reserve

Regulatory/Third Party Reserves

- 7 Community Revitalization Levy Reserve - Belvedere
- 8 Community Revitalization Levy Reserve - Downtown
- 9 Community Revitalization Levy Reserve - Quarters
- 10 Commonwealth Stadium Reserve
- 11 Funds-in Lieu Reserve
- 12 Motor Vehicle Insurance Reserve
- 13 Parkland Reserve
- 14 Rogers Place Arena Capital Reserve
- 15 St. Francis Xavier Reserve
- 16 Telus Field Capital Reserve

Specific Purpose Reserves

- 17 Affordable Housing Reserve
- 18 Brownfield Redevelopment Reserve
- 19 Developer Recoveries Reserve
- 20 Development Incentive Program Reserve
- 21 Enterprise Portfolio Reserve
- 22 Facade & Storefront Improvements Reserve
- 23 Financial Stabilization Reserve/Appropriated Reserve
- 24 Fleet Reserve
- 25 Heritage Reserve
- 26 Interim Financing Reserve
- 27 Local Improvements Reserve

Appendix 2 Cont'd - City of Edmonton Reserve Funds

28 LRT Reserve

29 Natural Areas Reserve

30 Neighbourhood Renewals Reserve

31 Pay-As-You-Go Reserve

32 Revolving Industrial Servicing Fund Reserve

33 Traffic & Safety Automated Photo Enforcement Reserve