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# AUDITOR GENERAL

Halifax Regional Municipality

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## A Performance Review of the Management of Halifax Regional Municipality's Reserve Funds<sup>©</sup>

**November 2015**

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## Preamble

The Halifax Regional Municipality (HRM) Charter specifies in Section 120 (1) “the Municipality shall maintain a capital reserve fund”. It also specifies in Section 120 (6) “the Municipality may maintain other reserve funds for such purposes as the Council may determine”. According to HRM’s Audited Financial Statements at March 31, 2015, HRM had reserves totalling \$181,891,000 comprised of capital and equipment reserves totalling \$137,184,000 (29 funds) and operating reserves totalling \$44,707,000 (23 funds)<sup>1</sup>. To manage reserves, Regional Council approved Administrative Order Number 2014-015-ADM Respecting Reserve Funding Strategies (Financial Reserves Administrative Order) on October 28, 2014. The passing of this Administrative Order repealed the previous reserve policy approved December 1, 1998.

## Objectives

To verify whether procedures and controls around the management of reserve funds ensures an effective use and demonstrates good stewardship of funds.

In order to satisfy this objective, the OAG developed the following lines of enquiry:

- 1.0 To determine if policies and procedures adequately describe the purpose and use of reserve funds as well as the process to access the funds.
  - a. A policy has been adopted which provides clarity over use of reserve funds.
  - b. The policy has been approved by Regional Council and is reviewed on a regular basis.
  - c. Detailed procedures exist outlining the process to access reserve funds.
- 2.0 To review how the Municipality determines the types of reserves which should be established.
  - a. Reserves are established for future use based on a strategic risk assessment which determines the types of reserves HRM should fund.
- 3.0 To review if effective controls and processes are in place for managing specific reserve funds.

<sup>1</sup> According to HRM’s Financial Statements at March 31, 2015, HRM had 52 open reserves.

- a. Business cases are prepared for the establishment of reserve funds, identifying the intent of the reserve, the funding source, the targeted minimum and maximum level for the reserve funds, the process to follow when the fund becomes fully funded or falls below the targeted minimum and the process to close the reserve.
  - b. Establishment, use, transfer in/out and closure of reserves is authorized by Regional Council.
  - c. Accounting controls are in place to ensure the appropriate funding sources are used to fund specific reserves and to ensure the expenditures from the reserves are as specified in the business case. Transactions do not take place prior to Regional Council approval.
  - d. Reserve funds are reviewed on a regular basis to ensure the transactions are consistent with the established business case and the projected cash flows are consistent with the goals of the fund.
- 4.0 To review if reporting of funding and use of reserve funds is transparent and understandable.
- a. Information provided to Regional Council is complete, clear and understandable for effective decision making.
  - b. Available financial information is transparent and provides adequate information to taxpayers on the management of reserve funds.

**Scope**

Reserve transactions were reviewed for the past five years to identify possible trends and patterns in the use of reserve funds.

Only reserves listed in the consolidated financial statements of HRM were included in this review.

During the review period, 15 new reserves were opened, ten reserves were closed and, according to HRM's Financial Statements, 52 reserves remained open at March 31, 2015. The OAG reviewed newly opened and closed reserves as well as reserves opened prior to the review period. The OAG also reviewed all business cases provided by Finance and Information, Communication and Technology (FICT) staff. This included 53 business cases; eight of which were business cases for reserves which were closed prior to March 31, 2015. Six open reserves as at March 31, 2015 had no accompanying business cases.

Reserve funds maintained by Halifax Regional Water Commission were excluded from the review.

**Methodology**

Meetings with FICT employees responsible for reserve fund transactions and preparation of reporting of reserve fund transactions to Regional Council.

Review of Regional Council and Audit and Finance Standing Committee minutes for decisions to support management of reserve funds.

Analysis of financial trends and reserve fund balances over the five-year review period.

Review of HRM Charter for specific legislation applicable to reserve funds.

## Executive Summary

Prior to undertaking this project and the commitment of resources, the Office of the Auditor General (OAG) completed an environmental scan of Halifax Regional Municipality (HRM) reserve funds. The purpose of this initial work was to properly plan the project and develop lines of enquiry which would address the chosen objectives. During the environmental scan the OAG was informed HRM staff have started a project to review reserves as they currently exist. However, staff are in the early stages of the project and do not know when the project will be completed.

As a result of the environmental scan and the use of reserve funds to offset the 2014/15 general rate deficit, the OAG concluded the focus of the report would be to verify whether procedures and controls around the management of reserve funds ensure appropriate reserves are maintained, reserve funds are being used effectively and good stewardship of funds is demonstrated.

The State of New York's Local Government Management Guide provides a good description of the intended use of reserve funds: "Reserve funds, like other savings plans, are mechanisms for accumulating cash for future capital outlays or other allowable purposes. Saving for future capital needs can reduce or eliminate interest and other costs associated with debt issuances. Similarly, certain reserve funds can be utilized to help protect the budget against known risks or unknown risks."<sup>2</sup> This definition explains reserves are savings plans for future cash expenditures; in the municipal setting maintaining reserves requires the current taxpayer to put funds away now for the future taxpayer or for unforeseen events.

The OAG recognizes there are many benefits to having reserve funds but believes the reserves must be part of a strategic plan and effectively managed in order for these benefits to be fully realized. Reserve funds set aside for capital purposes should be part of a long-term capital plan and reserves set aside for operating purposes should mitigate identified risks to the Municipality. The OAG believes in order for an organization to use reserves effectively it must be clear on the known and unknown risks and future capital requirements.

The OAG also believes funds set aside for reserves should be governed by the terms set out in the HRM Charter. The HRM Charter outlines the Municipality's responsibility for maintaining the required capital fund and

<sup>2</sup> Office of the New York State Comptroller Division of Local Government and School of Accountability Local Government Management Guide, January, 2010.

Council's responsibility for determining what other reserves the Municipality needs. In the view of the OAG, this strongly suggests Regional Council is responsible for the oversight of reserves and ensuring they are being effectively managed to demonstrate good stewardship of funds.

With this in mind, the OAG identified the following expectations for HRM reserves management:

- A clear and concise definition of what a reserve is which is understood and agreed to by all,
- Regular discussion at Regional Council around reserves, including:
  - What specific reserves are needed
  - How the reserves will be funded
  - The targeted level of reserves
  - What risks the reserves will mitigate
  - The part reserves play in the fiscal sustainability of the Municipality,
- Oversight by Regional Council and clear accountabilities/responsibilities delegated to the Chief Administrative Officer and the Director of Finance,
- Performance reporting (comparisons to budget as well as impacts of using reserves for unexpected or unintended purposes),
- Linkage to the Corporate Strategy and Capital Plan,
- Compliance with legislation,
- Internal controls around authorities for the establishment, monitoring, funding and movement of funds and
- Transparency around reserves which promotes a clear and consistent understanding by all.

In order to assess whether the Municipality met these expectations, the OAG developed the following fundamental questions around reserves:

#### **Are there Sufficient Governing Policies and Guidelines around Reserves?**

The HRM Charter requires HRM to maintain a capital reserve fund and allows for Regional Council to create additional reserves. Regional Council approved Administrative Order Number 2014-15-ADM Respecting Reserve Funding Strategies (Financial Reserves Administrative Order) on October 28, 2014 and Finance and Information, Communication and Technology (FICT) has developed guidelines for the establishment, funding, use, review and closure of all financial reserves. The OAG found these to include all the components for good control and stewardship of reserve funds however, these policies and guidelines must be followed appropriately in order for the effectiveness

to actually take place. During the review, the OAG observed occurrences of the Financial Reserves Administrative Order and Corporate Guidelines for Reserves not being followed. The OAG also found some ambiguity in the language used in the Financial Reserves Administrative Order to categorize the various types of reserves.

#### **Does HRM have a Process to Determine the Necessary Types and Targeted Levels of Reserves?**

The Municipality maintains a large number of separate reserve funds (52 totalling \$181,891,000 as at March 31, 2015). The OAG questions whether HRM has an adequate process in place to determine what reserve funds, other than the required capital reserve, the Municipality should establish and how much funding should be going to each reserve fund. The OAG believes in order for the Municipality to be strategic and demonstrate effective stewardship of funds, HRM must first determine the possible risks to the Municipality and opportunities available as well as estimate the future expenditures required for capital replacement and how these items may be funded. HRM then needs to determine the reserves needed and the necessary level of reserve funding. The OAG has repeatedly written about the importance of risk management in reports over the past number of years. The OAG was not able to identify any recent discussion by Regional Council to identify the risks which reserves have been set up to mitigate or to establish a target level of reserve funding. The OAG questions if the right level of savings is being undertaken by current taxpayers to fund projects which will benefit future taxpayers.

#### **Are the Established Internal Controls Being Followed?**

The Financial Reserves Administrative Order requires all reserves to have a business case approved by Regional Council. The specifications for business cases are also outlined in the Administrative Order. These specifications form part of the internal control framework around the management of reserve funds. During the review, the OAG identified instances where Financial Reserves Administrative Order requirements were not being followed.

**Establishment of Reserves** – At the time of the review there were six reserves without business cases, all being actively used; two of which were also identified as not having a business case in 2012. The lack of business cases is concerning to the OAG as it decreases the ability of staff to effectively make decisions in regards to reserve funding levels and potential projects to be funded through reserves. It is also the view of the OAG, Regional Council



cannot adequately fulfill their oversight responsibility without approved business cases for each reserve.

**Reserve Purposes** – The purpose of a reserve should be specific enough to justify having a separate reserve with a unique business case rather than simply allocating funds to/from the one general capital reserve the Municipality is required to have. A vague purpose allows for different interpretations over use of the funds and diminishes clarity of why the reserves were established in the first place. The OAG found multiple business cases with vague descriptions for the purpose of the fund. The OAG also found multiple reserves with similar purposes. It appears there is little control in place to ensure reserves are created for unique purposes, which do not overlap with other funding options.

**Funding Sources** – The OAG believes the method by which a reserve is funded should be clear and transparent in order to reduce the complexity, increase the clarity of HRM's reserve budgeting process and support strong financial planning. Some of the reserve business cases provide no clear explanation for the source of funds, so it is unclear to the OAG why some are funded through Fiscal Services<sup>3</sup> and some through specific business units. The OAG found eight reserves whose business cases outline a source of funds from another reserve however, the business cases for the reserves where the funds are being transferred from do not list inter-reserve transfers as an intended use of the reserve. The OAG also found when there was no pre-determined amount identified in the business case to be allocated to the reserve, it would appear annual allocations may be made based on available funds in the Fiscal Services budget and therefore not based on a requirement or need. It is not clear whether the amount allocated is sufficient to satisfy the reserves' purposes or whether 'extra' funds are being added to the reserves.

**Targeted Level of Funding** – Out of the 53 reserve business cases reviewed, only 20 have specific funding minimums, maximums and/or targets and none have all three. It is the view of the OAG this presents a risk to the Municipality as without these components, HRM staff have no guidance from Regional Council as to what level to fund reserves. The OAG believes without minimums and maximums or a procedure to manage over or underfunded reserves, the Administration's ability to plan and manage the funding of reserves becomes more difficult.

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<sup>3</sup> Fiscal Services, "includes HRM's financial responsibilities and obligations that are not directly related to a specific Business Unit" (Proposed Operating Budget 2015/16). Fiscal Services is now referred to as Corporate Accounts in the most recent budget books. For consistency, the OAG has used Fiscal Services throughout this report.

**Review Process** – The OAG could not find evidence of a formal review process for all reserves. The only review outside of the budgeting process was the ‘Ten Year History of Reserves’ Report presented to Regional Council in January 2013 as an information item. According to FICT staff “there has not been a formal review of all reserves”. Reserve business cases state varying review periods, from yearly reviews to reviews every ten years. The business cases also vary from what is prescribed in the Financial Reserves Administrative Order and Corporate Guidelines for Reserves. Without a proper detailed and consistent review of reserves the OAG questions how HRM Administration and Regional Council can make strategic decisions on when to establish a new reserve, when to contribute funds to existing reserves or which reserves to close.

**Closure Process** – There is no clear process for closing out reserves. There is also no process to guide where to re-allocate the remaining funds of the reserve being closed and no requirement for this to be presented to Regional Council. During the period of review the OAG observed a reserve had its remaining balance transferred to another reserve prior to closing without any direction from Regional Council.

#### **Are there Adequate Accounting Controls?**

The OAG would expect to find sufficient accounting controls in place, supporting the Financial Reserves Administrative Order, to ensure appropriate sources are used to fund specific reserves and to ensure the expenditures from the reserves are as specified in the business case. However, the OAG found deviations from policy in the management of funds and HRM Administration has not formalized many of their practices. The OAG is concerned there is a risk the internal accounting controls for reserves are not strong enough to ensure effective management of reserve funds.

#### **Is there Sufficient Reporting on Reserves for Decision Making Purposes and Does it Provide the Proper Level of Transparency?**

Summary information on all reserves is reported during the budget process as well as in the quarterly financial reporting. There is a risk this high-level information is not transparent enough to clearly demonstrate the effects unplanned reserve transfers have on reserve accounts or the current or a future budget. Since this financial information does not clearly identify the amount of reserve funding included in the accounts of the Municipality, it is difficult to identify the true cost to conduct Municipal operations and for Regional Council to make strategic decisions based on the information

presented to them. The OAG is concerned current reporting is not transparent enough for the average taxpayer to easily determine how much of their tax dollars is being spent on yearly operations and how much is being saved for the future.

The OAG observed in fiscal year 2012/13 three inter-reserve transfers which were not included in the annual budget process or as part of the 'application' of funds in the reserve business cases. The OAG understands it is acceptable for these funds to be re-allocated based on strategic direction from Regional Council but there is no evidence of this direction being given. It is concerning to the OAG funds can be moved out of reserves for purposes not consistent with the approved reserve purpose or without specific direction from Regional Council. It is also concerning to the OAG reserves can become overfunded for two fiscal years before any action is taken, as this is funding which could be re-allocated for other purposes or to potentially contribute to a reduction in the general tax rate. If Regional Council was made aware of the amount of overfunding in reserves, a strategic decision could be made as to how to proceed with re-allocation. In the current practice, Regional Council is only made aware of the overfunding when a recommendation to transfer the funds is being proposed.

To cover the 2014/15 operating deficit, HRM staff recommended a number of transfers out of reserve accounts to the operating budget, which Regional Council approved. Funds were transferred out of five different reserves. The OAG expected to see detailed information around the impact to the reserves' balances or plans for replenishment of reserves but could not find any. If these transfers did not, in fact, have an adverse impact on the funding level of these particular reserves, the OAG questions why these reserve funds were allowed to become overfunded or why funds were committed but not needed and why this was not presented and discussed with Regional Council. The OAG finds it concerning reserve funds may be overfunded without this being clearly disclosed and also not having a debate around the proper re-allocation of the overages.

### **Conclusion**

The OAG understands the necessity to plan for unforeseen issues or events which do not occur annually, however if reasons for creating and funding reserves are not clearly articulated, reserve funds may be seen as nothing more than a pool of funds, which can be re-allocated to be used to cover poor budgeting and planning decisions.

It is difficult for the OAG to conclude there is effective management of reserve funds when:

- there is no specific or accepted process in place to identify which reserves are needed, when they are needed and how much funding should be set aside,
- funds can be transferred in and out of reserves without following the HRM Charter, Financial Reserves Administrative Order or Corporate Guidelines for Reserves,
- funds may be transferred in and out without a supporting business case,
- capital funds may be transferred to operating without a replenishment plan,
- transfers are being made from reserves contrary to the purpose of the reserve and
- specific controls are in place around reserve funds, which have been accepted by the organization, however these controls are not functioning as intended and there is not adequate support for the deviations.

## Summary of Recommendations

The following recommendations are printed verbatim from the detailed findings section of the report. To appreciate the full intent of the recommendations, they should be read in context of the section of the report indicated by the page numbers.

- 2.0.1 The OAG recommends HRM Administration conduct a corporate risk assessment to identify all risks and then determine whether these risks should be mitigated using reserve funds. (Page 28)
- 2.0.2 The OAG recommends HRM Administration determine and document what opportunities may qualify as reasons to fund reserves. (Page 28)
- 2.0.3 The OAG recommends HRM Administration determine and document capital projects which are anticipated to be funded through capital reserves for the full five-year capital plan. (Page 28)
- 2.0.4 The OAG recommends, for greater clarity, HRM Administration categorize existing reserves by the types specified in the Financial Reserves Administrative Order. (Page 28)
- 2.0.5 The OAG recommends HRM Administration have discussions with Regional Council regarding the targeted level of reserves. (Page 28)
- 3.0.1 The OAG recommends HRM Administration ensure each reserve follows the Financial Reserves Administrative Order by having an approved business case before any funding or use of the reserve is allowed. (Page 44)
- 3.0.2 The OAG recommends HRM Administration review all reserves and ensure each is for an appropriate, specific purpose and close or combine any overlapping reserves. (Page 44)
- 3.0.3 The OAG recommends HRM Administration ensure when any new reserve is created it is unique and the purpose could not be satisfied using an existing reserve or could not be considered an ongoing operating expense and therefore not appropriate for reserve funding. (Page 44)
- 3.0.4 The OAG recommends HRM Administration ensure all reserve business cases have a specific funding source(s), supported by a calculation to fund to a specific level. (Page 44)

- 3.0.5 The OAG recommends HRM Administration ensure the funding source is clearly supported, including matching to specific business units when applicable. (Page 44)
- 3.0.6 The OAG recommends HRM Administration ensure each reserve business case has a specific targeted funding level, including a minimum and maximum funding amount and have these amounts evaluated on a regular basis to ensure they are sufficient given the purpose of each reserve. (Page 44)
- 3.0.7 The OAG recommends HRM Administration ensure there are clear instructions for how to proceed when a reserve is over or underfunded according to its' minimum or maximum. This includes whether or not interest can be allocated to reserves when overfunded. (Page 45)
- 3.0.8 The OAG recommends HRM Administration develop and document a formal review procedure, including a presentation to Regional Council on the current status of all reserves. It is also recommended HRM Administration ensure any review procedure is comprehensive. (Page 45)
- 3.0.9 The OAG recommends HRM Administration ensure all reserve business cases include a detailed timeline which would outline the expected contributions and withdrawals over the life of the reserve, with a clear closure process, especially when reserves are not permanent in nature. (Page 45)
- 3.1.1 The OAG recommends HRM Administration develop and document a standard process to access reserve funds. (Page 51)
- 3.1.2 The OAG recommends HRM Administration ensure all reserves have clearly documented authority which matches the purpose of the business case and reserves policy. (Page 51)
- 3.1.3 The OAG recommends HRM Administration document the current process of ensuring availability of funds for unplanned transactions and ensuring they are in accordance with the purpose of the reserve as stated in the business case. (Page 51)

- 3.1.4 The OAG recommends HRM Administration formalize and document reserve accounting controls in regards to:
- a. ensuring the approved funds are transferred to and from reserves and
  - b. ensuring all errors can be easily identified and corrected on a timely basis. (Page 51)
- 3.1.5 The OAG recommends HRM Administration ensure all reserve reporting is consistent; specifically, Fourth Quarter Financial Reports and beginning balances of the reserve reports agree to audited financial statements. (Page 51)
- 3.1.6 The OAG recommends HRM Administration implement and document stronger controls around ensuring reserves and reserve fund transfers are allowed under the applicable legislation. (Page 51)
- 3.1.7 The OAG recommends HRM Administration provide legal advice to Regional Council to interpret the HRM Charter in regards to the guidelines for the capital reserve fund and the use of capital reserves. (Page 51)
- 4.0.1 The OAG recommends HRM Administration work with Regional Council to decide what information Regional Council requires to make strategic decisions with regards to reserve funds and have it incorporated into the financial reporting. (Page 56)
- 4.0.2 The OAG recommends HRM Administration set a standard for reporting unplanned reserve transactions to Regional Council which includes the impact to the reserve and the budget. (Page 56)
- 4.0.3 The OAG recommends HRM Administration disclose the transfers to and from the reserves in the financial results of the Municipality. (Page 56)
- 5.0.1 The OAG recommends HRM Administration report the amount of overfunding by reserve to Regional Council as a part of the annual budgeting process so there can be discussion around the appropriate re-allocation of these funds. (Page 62)
- 5.0.2 The OAG recommends HRM Administration provide documented support for a recommendation to transfer reserve funds for a purpose inconsistent with the reserve's approved business case. (Page 62)

- 5.0.3 The OAG recommends HRM Administration clarify the authorities of the Director of Finance in the Financial Reserves Administrative Order. (Page 62)
  
- 5.1.1 The OAG recommends HRM Administration, when recommending a transfer from a reserve outside of the business case purpose, present a schedule to replenish the reserve, in addition to presenting the impact on the reserve fund. If no replenishment is required, there should be a documented explanation as to why. If the reason is overfunding, a description of how this occurred and how this will be prevented from happening in the future should be included. (Page 65)
  
- 5.1.2 The OAG recommends HRM staff review if the current reserves and purposes adequately fit the Municipality's current needs and anticipated future needs. (Page 65)



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## **Detailed Findings and Recommendations**

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## 1.0 Introduction to Reserves and HRM Reserve Policies

Organizations, including not-for-profits and public sector entities, use financial reserves as a method for strategic financial planning considering current and future needs while promoting financial sustainability. Organizations use various reserve funds to carry forward specially designated funds from one fiscal year to another for reasons including:

- to finance particular operating expenditures (including unforeseen) in a future fiscal year,
- to have sufficient funds available for major capital projects,
- to provide for contingency funds to offset future tax rate increases which would otherwise be required or
- to have funds available to address major disaster and emergency response costs.

### What Makes Reserves Effective

In order for reserves to be effective they must be carefully managed. The Office of the Auditor General (OAG) believes having strong policies and guidelines around the purpose and use of reserve funds promotes effective management and good stewardship of public funds however, the policies and guidelines must be followed appropriately in order for the effectiveness to actually take place.

**Having strong policies and guidelines around the purpose and use of reserve funds promotes effective management and good stewardship of public funds.**

The OAG's research into the components of a strong reserve fund policy included a review of Government Finance Officers Association (GFOA) standards as well as a review of other municipalities and not-for-profit organizations with reserve policies. The OAG noted the following common themes:

- Clear purpose
- Designated authorities
- Target funding level and supporting calculations
- Standard and regular review process

Section 120 (1) of the Halifax Regional Municipality (HRM) Charter requires HRM to maintain a capital reserve fund. Section 120 goes on to detail what is to be included in the capital reserve and what the capital reserve can be used

for. This is the only named reserve specifically identified in the HRM Charter. Section 120 (6) details Council “may maintain other reserve funds for such purposes as the Council may determine”. This allows, for example, the establishment of operating reserves. However, the HRM Charter only provides guidelines around the use of the named capital fund.

### Basis for HRM Management of Reserves

The OAG reviewed the current policies and procedures in HRM dealing with reserves. In 2014 HRM repealed the Financial Reserves Policy with the passing of Administrative Order Number 2014-15-ADM Respecting Reserve Funding Strategies (Financial Reserves Administrative Order).

The Financial Reserves Administrative Order specifies “the establishment of a Reserve shall require:

- (a) a clear and specific purpose which captures the strategic goal and related success factors, and such purpose shall be set out in the Reserve Business Case;
- (b) identifying the source of the funding for the Reserve and its relation to its stated purpose;
- (c) identifying the risks and consequences of not establishing the Reserve;
- (d) identifying a maximum and minimum balance which should be set to meet the purpose of the Reserve, and identified in the Reserve Business Case; and
- (e) setting a start and end date for the Reserve based on its purpose, including any required conditions for renewal.”

The Financial Reserves Administrative Order also details specific responsibilities for:

- Regional Council – approval of reserve budget, approval of business cases, approval of any unbudgeted withdrawals from reserves,
- Audit and Finance Standing Committee – review and recommend to Council for their consideration all impacts to the reserves,
- Chief Administrative Officer (CAO) – may recommend to Council reserve funds be expended,
- Director of Finance – review reserve funds annually for relevance and for compliance to business cases and relevant municipal policies. Provide Council with an annual report on reserves activity and balances. Recommend when it is appropriate to close any reserve the purpose of which is outdated or combine reserves with similar purposes.

HRM also has documented Corporate Guidelines for Reserves to provide further interpretation and guidance to the Financial Reserves Administrative Order. The guidelines expand on the authority, process and business case content as well as provide guidance around business case and account review.

Through a review of the Financial Reserves Administrative Order and the Corporate Guidelines for Reserves, the OAG found HRM has included all of the components for good control and stewardship of reserve funds. The Financial Reserves Administrative Order requires each reserve to have a purpose, authorities, target funding and a standard review process.

While the Financial Reserves Administrative Order and Corporate Guidelines for Reserves represent good controls for effectively managing reserves and demonstrating good stewardship of funds, the OAG found general business practice at HRM is not always consistent with the Financial Reserves Administrative Order or Corporate Guidelines for Reserves. This will be discussed in the following report sections where testing to the policy and guidelines was performed.

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**The OAG found general business practice at HRM is not always consistent with the Financial Reserves Administrative Order or Corporate Guidelines for Reserves.**

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## 2.0 Lack of Clarity on Types and Targeted Funding Levels of Reserves

The OAG reviewed, in detail, the HRM Charter focusing on what the Charter specifically mandates for the Municipality in regards to financial reserves. The HRM Charter Section 120 (1) states, “the Municipality shall maintain a capital reserve fund”. The HRM Charter Section 120 (3) specifies “the capital reserve fund includes

- (a) funds received from the sale of property;
- (b) the proceeds of insurance resulting from loss or damage of property that is not used for replacement, repair or reconstruction of the property;
- (c) any surplus remaining from the sale of debentures that is not used for the purpose for which the debentures were issued;
- (d) the surplus remaining in a sinking fund when the debentures for which it was established are repaid;
- (e) any capital grant not expended in the year in which it was paid;
- (f) proceeds received from the winding up of a municipal enterprise as defined in the *Municipal Finance Corporation Act*;
- (g) the current fiscal year's accrual for landfill closure and post closure costs; and
- (h) amounts transferred to the fund by the Council.”

As was previously mentioned, the HRM Charter allows for HRM to have reserve funds in addition to the required capital fund. Given the fact the Municipality may maintain separate reserve funds, the question becomes whether HRM has a process in place to determine what reserve funds, other than the capital reserve specified in legislation, the Municipality should establish and how much funding should be placed in each reserve fund.

**The question becomes whether HRM has a process in place to determine what reserves should be established and how much funding should be placed in each reserve fund.**

In support of the HRM Charter requirements, Regional Council has passed the Financial Reserves Administrative Order which specifies the purposes for reserve funds:

- (1) “Council may only create Reserves for the following purposes:
  - (a) a contingency fund for opportunities;
  - (b) a contingency fund for risk; and
  - (c) a saving funds for future obligations.
- (2) A contingency fund for opportunities recognizes that:
  - (a) not all expenditures are planned or anticipated; and

- (b) an opportunity may arise to develop services or achieve efficiencies and that the Municipality must react rapidly or lose that opportunity, such as a sudden change in the economy or the introduction of cost shared programs from other levels of government or the private sector.
- (3) A contingency fund for risk recognizes that:
- (a) the financial risk of unforeseen events involving substantial costs, such as emergencies or economic events, and that a Reserve can mitigate this risk by providing funding for sufficient public safety or preventing service interruptions.
  - (b) a withdrawal from a contingency fund for risk must be quantifiable or subject to estimate based on assumptions.
- (4) A saving fund for future obligation recognizes that:
- (a) an obligation may be associated with recapitalization of a specific asset where the estimated lifecycle cost of an asset can be reasonably estimated;
  - (b) an obligation may be associated with a strategic plan where the asset or project may not yet be specified, such as the purchase of land; and
  - (c) that a future expenditure may be managed through the long-term operating or capital budget, depending on the magnitude or situation of the obligation.”

The OAG understands the need to identify the purposes reserves can be established for however, the Financial Reserves Administrative Order does not specify how the Municipality defines an opportunity other than the example provided or what the risks (emergencies or economic events) might be which need to be funded through the use of reserve funds. As well, 51 of the current 52 reserves have not been categorized by the types listed above other than being categorized as either operating, capital or equipment reserves. A project is being undertaken by Finance, Information Communication and Technology (FICT) to review the current reserves. While the current Financial Reserves Administrative Order will be the basis for this review, it is not clear whether the current project will categorize the reserves since there is no project charter outlining the scope or deliverables for the project.

The OAG believes, in order to be strategic in its use of reserves and demonstrate effective stewardship of funds, the Municipality needs to determine the types of reserves required and the necessary level of reserve funding. In order to do so, the Municipality must first determine the possible

risks and opportunities as well as estimate future expenditures required for recapitalization<sup>4</sup> or capital replacement and how these items may be funded.

**In order for the Municipality to determine the types of reserves needed and the necessary level of reserve funding, it must first determine possible risks and opportunities.**

### Identification of Opportunities

The OAG does not believe the identification of an opportunity to receive funding from another source is necessarily a reason to fund more reserves. Any project which may be applicable for funding from other levels of government should already be a project being contemplated by the Municipality but the source of funds may become different. As the OAG found in 'A Performance Review of the Washmill Lake Court Extension Project<sup>®</sup>', HRM took advantage of federal infrastructure funding for a project which was not truly 'shovel ready' which resulted in cost overruns and other issues. The OAG continues to caution HRM when considering these types of opportunities.

Cost-shared programs with the private sector are generally not sudden since the private sector would be planning for intended investments or other expenditures and would most likely involve various levels of government because of the need for approvals or permits. The OAG also believes changes in HRM economic conditions are generally not sudden (within one fiscal year). This type of situation is more likely to occur in a municipality which depends on one industry or plant. For example, if an unanticipated announcement is made to expand/close a plant, it would be a 'sudden' economic impact. Since HRM is large enough to have multiple sectors, this type of economic impact is not felt as acutely. Therefore, the OAG concludes, based on the description included in the Financial Reserve Administrative Order, HRM Administration has not clearly defined what should/could be considered opportunities for the Municipality and the possible impact on reserve funding.

**HRM Administration has not clearly defined what should/could be considered opportunities for the Municipality and the possible impact on reserve funding.**

<sup>4</sup> Recapitalization – The use of funds to develop and improve existing assets which have deteriorated through the passage of time and/or a lack of maintenance. Proposed Operating Budget 2015/16 – Glossary Page T10.

## Risk Identification

In the case of risks, a corporate-wide risk assessment has not been conducted identifying the risks to HRM and which risks should be mitigated using reserve funds. Staff have begun a draft risk analysis using a template developed by the Government Finance Officers Association (GFOA) however, as of September 22, 2015, the OAG was advised the risk analysis had not been discussed with members of Regional Council. Therefore, it is possible what the Administration considers high/low risk may not be considered high/low risk by Regional Council. A more comprehensive risk analysis would include input from various stakeholders including Regional Council to come to a risk rating by consensus. The OAG believes in order for the GFOA analysis template to be effective, it should be supported by a corporate-wide risk assessment with determinations within the assessment of which risks management intends to mitigate through the use of reserve funds and have these mitigation strategies accepted by Regional Council.

The risk analysis template is also a tool for guiding the selection of a 'general reserve fund balance target'. Part of the GFOA risk analysis template assesses the vulnerability to extreme events and the volatility of revenues and expenditures. Higher risk rankings are assigned to governments vulnerable to extreme events and with highly volatile revenues or expenditures. Other factors considered include financial flexibility, leverage, whether there are other funding sources, the potential growth of the municipality and the potential capital projects without funding sources. The higher the ranking, the higher the fund balance target recommended<sup>5</sup>.

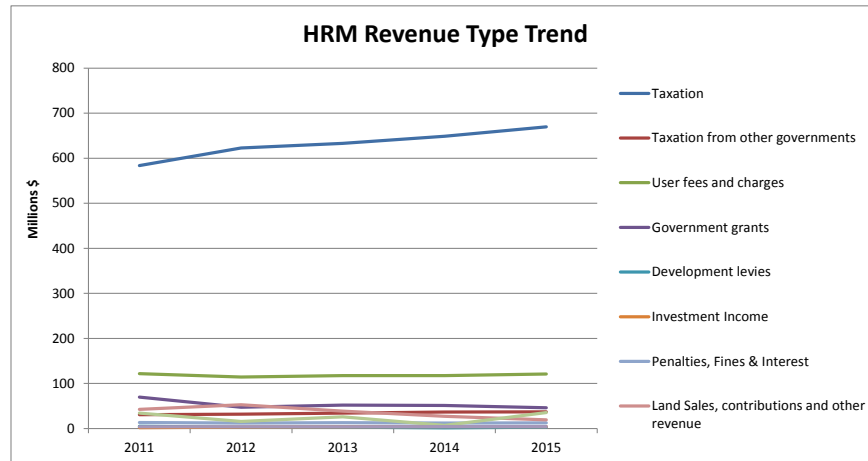
The OAG conducted a limited analysis of HRM revenues and expenditures over the past five years. HRM consistently receives 70% of its revenue from tax revenue (amounting to about \$670 million for the year ended March 31, 2015 as indicated in Exhibit 1 below). Taxation revenues have been gradually increasing; however, other revenues have remained relatively stable.

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<sup>5</sup> Government Finance Officers Association – Guiding Your Selection of a Fund Balance Target



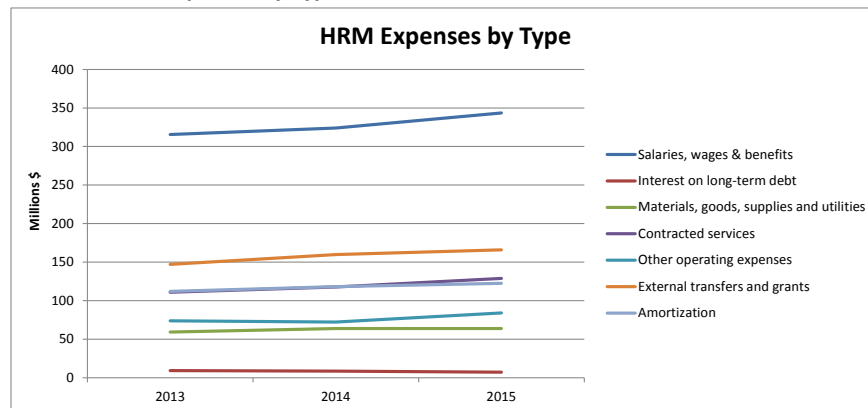
**Exhibit 1: HRM Revenue Trends (\$) 2011 to 2015**



Data Source: HRM Audited Financial Statements

HRM’s expenses also appear consistent year over year. Exhibit 2 shows the expenses for the past three years for salaries, wages & benefits, interest on long-term debt, materials, goods, supplies and utilities, contracted services, etc.

**Exhibit 2: HRM Expenses by Type 2013 to 2015**



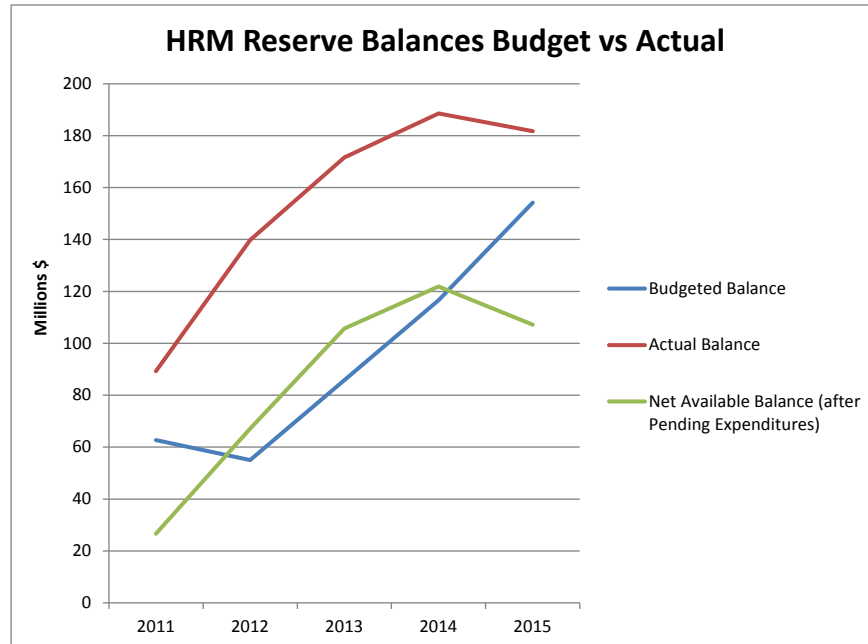
Data Source: HRM Audited Financial Statements

Note: This disclosure was not presented in the 2011 and 2012 Audited Financial Statements.

When analyzing the revenue and expenditures from 2011 to 2015, the OAG concludes there is virtually no volatility. As well, as Exhibit 3 indicates, the actual balance in reserve funds has increased more than the budgeted amount because operating surpluses have contributed to the reserves. Even though the reserve funds have been increasing, the OAG concludes it is not clear what the overall intended target is for the reserves.

**Even though the reserve funds have been increasing, the OAG concludes it is not clear what the overall intended target is for the reserves.**

**Exhibit 3: HRM Reserve Balances (\$) 2011 to 2015**



Data Source: Year End Reserves Spreadsheet Prepared by HRM Finance, Information, Communications and Technology, terminology as used in the Year End Reserves Spreadsheet.

Actual Balance (red line) represents the final balance at March 31 of each fiscal year

Budgeted Balance (blue line) represents the anticipated ending balance as approved in the HRM budget

Net Available Balance (green line) represents the balance available after allocations for approved transactions not yet incurred

### Target Level of Reserves

The Nova Scotia Department of Municipal Affairs has established financial indicators and thresholds as benchmarks for municipalities to use. It sets Operating Reserves as greater than 10% of operating expenditures (5% for years prior to 2012) as a threshold (no maximum is set) however, HRM does not meet this threshold. HRM Administration has reported to Regional Council during budget deliberations they believe this threshold to be too high. The Department of Municipal Affairs has also established a 5-Year Contributions to Capital Reserves Indicator calculated as “total contributions to capital reserves over a 5-year period ÷ total depreciation accrued over the same 5-

year period<sup>6</sup> with a threshold of 10%. HRM is well above this threshold however, it is still not clear if this threshold is appropriate for HRM. The OAG researched other municipalities throughout Canada and found reserves as a percentage of expenditures varies widely so it appears to depend on the individual needs of the municipality. The OAG was not able to identify any recent discussion by Regional Council to establish a target for the amount of reserves HRM should fund.

**The OAG was not able to identify any recent discussion by  
Regional Council to establish a target for the amount of  
reserves HRM should fund.**

### Capital Replacement and Recapitalization

For capital replacement and recapitalization, HRM Administration prepares an annual capital budget as well as a five year capital plan. The 2015/16 Approved Capital Budget specifies the amount of the estimated expenditures which will be funded from the reserves but it is not clear what the funding sources are for the remaining four years of the capital plan. Over the review period, the funding sources have typically been itemized for the upcoming budget year plus the next two years however, in the 2015/16 Approved Capital Budget, the funding sources were only indicated for the upcoming budget year. Therefore, it is not clear what the anticipated impact is on reserves of funding capital projects for the four years following the current budget year. Cash flow projections are sometimes included in the business cases for specific reserves however, the use of reserve funds in these specific cases has not been clearly linked to the capital budget.

The OAG questions what level of savings should be undertaken by the current taxpayers to fund projects which will benefit future taxpayers. In other words, it is not clear as to whether the goal of the current Regional Council is to have full reserve funding in place for capital replacements expected for some future date or whether the funding will be a combination of debt, reserves or transfers from other levels of government which will be decided as projects are undertaken. It is expected the funding of capital projects may be a combination of all possible funding sources however, it is not clear what the breakdown is expected to be. When funding sources, other than reserves, are being considered, it is not clear the Administration has determined the risks around whether these funding sources will, in fact, be available in the future.

<sup>6</sup> Indicator Definitions, Municipal Affairs, Government of Nova Scotia. Retrieved from <http://novascotia.ca/dma/finance/indicator/definitions.asp?def=73> on October 23, 2015.

**Recommendations:**

- 2.0.1 The OAG recommends HRM Administration conduct a corporate risk assessment to identify all risks and then determine whether these risks should be mitigated using reserve funds.
- 2.0.2 The OAG recommends HRM Administration determine and document what opportunities may qualify as reasons to fund reserves.
- 2.0.3 The OAG recommends HRM Administration determine and document capital projects which are anticipated to be funded through capital reserves for the full five-year capital plan.
- 2.0.4 The OAG recommends, for greater clarity, HRM Administration categorize existing reserves by the types specified in the Financial Reserves Administrative Order.
- 2.0.5 The OAG recommends HRM Administration have discussions with Regional Council regarding the targeted level of reserves.

### 3.0 Established Reserve Business Case Controls Not Being Followed

Internal controls are processes followed by staff to ensure the integrity of financial information, ensure compliance to legislation, policies and procedures, promote efficient and effective management and accomplish a program's objectives. As previously mentioned, the Financial Reserves Administrative Order and accompanying guidelines outline internal processes for management of reserves and use of reserve funds. Among these processes is the requirement for reserve business cases. According to the Financial Reserves Administrative Order "The establishment of a Reserve shall require:

- (a) a clear and specific purpose which captures the strategic goal and related success factors, and such purpose shall be set out in the Reserve Business Case;
- (b) identifying the source of the funding for the Reserve and its relation to its stated purpose;
- (c) identifying the risks and consequences of not establishing the Reserve;
- (d) identifying a maximum and minimum balance which should be set to meet the purpose of the Reserve, and identified in the Reserve Business Case; and
- (e) setting a start and end date for the Reserve based on its purpose, including any required conditions for renewal."

The Corporate Guidelines for Reserves provide further detail to support the business case content, including specific detail to be included in each required section of a reserve business case and outlining guidelines for inter-reserve transfers, interest earned and external funding sources. The OAG noted the previous reserve policy, which was repealed when the current Financial Reserves Administrative Order was passed, also required the purpose of the reserve be clearly defined in a business case.

#### OAG Review of Reserve Business Cases

As the new Financial Reserves Administrative Order and Corporate Guidelines for Reserves outline specific requirements for reserve business cases, the OAG requested and reviewed all of HRM's reserve business cases. Each business case was reviewed for a purpose, funding source, targeted fund balance, review and closure process.

Section 120 (6) of the HRM Charter states "the Municipality may maintain other reserve funds for such purposes as the Council may determine." The OAG interprets this to mean Regional Council is responsible for approving the

establishment of each reserve in the Municipality. According to the Financial Reserves Administrative Order, this is done through Regional Council's approval of a reserve business case prepared by staff.

As Regional Council is the sole authority for approving reserves, the OAG expected to see complete business cases for each reserve being approved by Regional Council before any deposits to or withdrawals from the reserve were made. However, at the time of the review, there were six reserves without business cases, all being actively used; two of the six were also identified as not having a business case in 2012 (in the Ten Year History of Reserves information report to Regional Council on January 29, 2013):

- 5594-96 Morris Street Reserve (Q112)
- Convention Centre Reserve (Q326)

The OAG is quite concerned for something as important as the Convention Centre and the risks associated with this venture, a reserve business case has still not been developed.

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**At the time of the review, there were six reserves without business cases, all being actively used.**

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The other four reserves without business cases were created after 2012. When asked how reserves are initiated without a business case, with the Planned Strategic Reserve (Q146) given as an example, staff indicated the reserve is a new reserve and was requested by the Director of Finance. According to staff,

“Council approval was obtained in concept of the creation of the reserve when they approved the Strategic Capital/ Reserve Presentation's recommendations in June 2014, with the business case pending to be done this year.”

The OAG reviewed the Strategic Capital Funding Strategy presentation, report and meeting minutes from Regional Council and Committee of the Whole and could not find evidence of Regional Council approval for the 'reserve in concept'. The motion Regional Council approved stated:

“Approve the use of the Capital Reserves Q101 Sale of Assets; Q126 Strategic Growth; Q139 Central Library Repayment Reserve; and Q145 Regional Facility Expansion Reserve to fund the Planned Strategic Projects and the Potential Strategic Projects should they proceed.”

The OAG questions if Regional Council determined the need for the Planned Strategic Reserve, or how Regional Council was even aware a reserve was being created during the discussion outlined above since there was no mention of a new reserve in the Regional Council resolution.

**The OAG questions how Regional Council was even aware a reserve was being created since there was no mention of a new reserve in the Regional Council resolution.**

It is also concerning to the OAG reserves are able to be funded and used before their establishment has been approved by Regional Council. Without a business case, staff cannot confirm the appropriateness of funds allocated to or from the reserve. The OAG observed a report to Regional Council on June 24, 2014 in regards to Tender Award 14-207, North Park Street Upgrades, included withdrawals from three reserves, one of which, the Operating Surplus Reserve (Q328), did not have a business case. Under the Financial Implications section of the report staff wrote:

“The Operating Surplus Reserve, Q328 is a new reserve, and a Reserve Business Case has not been developed as yet. Therefore, with no business case developed, the withdrawal from the reserve can’t be confirmed as meeting the purpose of the reserve per normal process. With Council’s approval however, funds can be withdrawn.”<sup>7</sup>

Regional Council approved funding from the Operating Surplus Reserve without an approved business case.

Also, the Strategic Studies Reserve (Q330) already had \$3,233,888 in funding allocated to it in the 2015/16 Operating Budget approved on April 28, 2015 prior to the business case being approved on June 2, 2015.

The HRM Charter states “the Municipality may maintain other reserve funds for such purposes as the Council may determine.” It is the view of the OAG, Regional Council cannot adequately fulfill their oversight responsibility without approved business cases for all reserves prior to any activity in the reserve. The lack of business cases is also concerning to the OAG as it completely eliminates staff’s ability to effectively make recommendations in regards to reserve funding levels and potential projects to be funded through reserves.

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<sup>7</sup> Page 10 of a staff report dated June 19, 2014, Approval of Increased Project Funding Award – Unit Price Tender No. 14-207, North Park Street Upgrades – North Park Street (Cogswell – Cunard) – West Region

## Review of Reserve Purposes

The OAG believes the stated purpose of a reserve is important in order to provide guidance on when to use the reserve and how it relates to the strategic direction of the Municipality. The purpose of a reserve should be specific enough to justify having a separate reserve supported by a unique business case rather than simply allocating funds to/from the one general capital reserve the Municipality is required to have.

**The purpose of a reserve should be specific enough to justify having a separate reserve supported by a unique business case rather than allocating funds from one general reserve.**

During the review, the OAG found the level of detail in the purposes section of each reserve business case varies. Some business cases are specific in their stated purpose and application of funds, such as:

- Snow and Ice Variable Operating Reserve (Q309)
- Municipal Election Reserve (Q313)

Other reserves are far less clear, such as the Strategic Growth Reserve (Q126) whose business case states the purpose as:

“To enable the municipality to respond to challenges posed to our service and infrastructure capability caused by population growth, rapid urban and suburban development expansion, changing demographics and rapid technological advancement.”

The OAG sees this as an excellent example of the consequences of not having clearly defined criteria and business cases. The elements of this reserve include:

- challenges posed to service and infrastructure capability caused by:
  - population growth,
  - rapid urban *and* suburban development,
  - changing demographics *and*
  - rapid technological advancement.

The OAG sees a number of issues which, in theory, could cause this reserve not to be able to be used:

- no benchmarks for when to use the reserve (i.e. what level of population growth),
- the need for both urban and suburban development and



- a change in demographics.

All of the above must be coupled or tied somehow to rapid technological advancement.

As well, it appears the purpose is to somehow respond to these challenges versus strategically planning for the future. The OAG is concerned this reserve now contains over \$27 million of the taxpayers money based upon the above flawed wording or criteria.

The description for the above noted reserve provided in the HRM Operating Budget indicates “Due to recommendations approved by Council on June 5, 2014, during Strategic Capital Budget discussions, a new business case will be developed in 2015/16 and presented to Council for approval as this reserve will be used for strategic items such as Police Station, Fire Services Training, Stadium, Library facilities, and possible Commuter Rail”.

Another example is the EMO Cost Recovery Reserve (Q314):

“To provide a source for certain internal H.R.M. departments to charge unbudgeted expenses arising out of a response to an emergency event.”

The title of the reserve does not seem to match the business case, as the title suggests there are costs being recovered; however, the business case does not mention anything about cost recovery. Furthermore, the purpose of the reserve is vague as the business case does not define an emergency event or specifically identify which HRM departments can ‘charge’ expenses here. A vague purpose allows for different interpretations and diminishes clarity of why the reserve was established in the first place. The average citizen, whose tax dollars are the source of the funds for essentially all reserves, would not likely completely understand why the reserve fund exists or when it should be used.

**A vague purpose allows for different interpretations and diminishes clarity of why the reserve was established in the first place.**

The OAG review also identified similar or overlapping reserves purposes such as:

- The Culture Development Reserve (Q312) and the Major Events Facilities Reserve (Q319): both reserves reference culture, where

Q319 is specifically for funding cultural facilities and Q312 is more broadly defined but does not exclude facilities.

- The Regional Facility Expansion Reserve (Q145) and the Planned Strategic Project Reserve (Q146): the OAG would assume a regional facility expansion would be classified as a planned strategic project. The Q145 reserve was closed in March 2015 with the majority of funds transferred to the Strategic Growth Reserve (Q126). The OAG still questions why one was able to be created while the other already existed.

Management in FICT have stated similar reserves will likely be collapsed as a result of the current review however, the OAG is concerned there have been reserves recently created which were similar in purpose to previously existing reserves, such as the examples noted above. Similar reserves may create confusion or ambiguity in which reserve to use for funding a particular expenditure. It appears there is little control in place to ensure reserves are created for unique purposes, which do not overlap with any other reserves or funding mechanisms.

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**It appears there is little control in place to ensure reserves are created for unique purposes, which do not overlap with any other reserves or funding mechanisms.**

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The OAG review also identified the Capital Replacement Reserve (Q130) as possibly overlapping in purpose. The purpose of the reserve is:

“To create an internal fund to support the replacement of HRM assets. The timing of replacing most assets can be reasonably estimated based on past experience or industry standards. With reasonable planning it is possible to plan for setting aside funding to partially or fully cover the cost of replacement.”

The OAG considers this purpose overlapping as there are also specific reserves with purposes which could be considered ‘capital replacement’. The following is list of examples, all of which have their own reserve.

- General fleet vehicles (Q204),
- Police vehicles and equipment (Q205),
- Fire & Emergency Service vehicles and equipment (Q206),
- Halifax Transit ferries (Q129) and
- Halifax Transit buses (Q143).

The OAG questions how staff decide which funding source to use when

multiple reserves could align with the stated need.

**The OAG questions how staff decide which funding source to use when multiple reserves could align with the stated need.**

The OAG found many operating reserves' stated purposes overlap with what the OAG considers to be ongoing operating expenditures, such as

- the DNA Costs Reserve (Q316),
- the EMO Cost Recovery Reserve (Q314) and
- the Strategic Studies Reserve (Q330).

The OAG questions how staff make decisions as to which method of funding is appropriate for different expenses, whether to draw from a reserve or to treat it as a current operating expense. The ability to choose when to use funding from a reserve or when to treat the expenditure as an operating expense can lead to the true ongoing costs of a business unit not being reported accurately; decreasing transparency to the taxpayer and HRM decision makers.

**The ability to choose when to use funding from a reserve or when to treat as an operating expense can lead to the true costs of a business unit not being reported accurately.**

Based on the examples above, the OAG concluded there is limited evidence the stated purposes in reserve business cases, as they are currently written, provide an effective control for decision making in regards to reserve management as many reserve purposes are vague and overlapping and could allow a single reserve to be used for a variety of purposes. Also, reserves set up for ordinary operating purposes allow for ambiguity and increase complexity when determining a funding source for a particular expenditure.

**There is limited evidence the stated purposes in reserve business cases, as they are currently written, provide an effective control for decision making.**

## Review of Reserve Funding Sources

The OAG believes the method by which a reserve is funded should be clear and transparent in order to reduce any ambiguity, increase the clarity of

HRM's reserve budgeting process and support strong financial planning. The OAG would expect to find a clear, logical connection between the purpose of any reserve and the source and amount of its' funding.

**The OAG would expect to find a clear, logical connection between the purpose of any reserve and the source and amount of its' funding.**

According to staff, the funding source for a reserve is determined by the business unit creating the reserve in consultation with the budget office, Director of Finance and/or CAO. In reviewing the individual reserve business cases, the OAG found there are different methods by which reserves can be funded:

- through contributions from the business unit with authority over the reserve,
- contributions from Fiscal Services<sup>8</sup>,
- transfers from other reserves,
- proceeds from the sale of land or other capital assets or
- other funding sources, such as user fees or contributions from external organizations.

**Exhibit 4: Count of the stated funding sources in all reserve business cases.**

Fiscal Services	Business Unit	Other Reserves	Sale of Land	Other Funding Source	Unclear
15	14	8	5	27	8

\*Some reserves may be counted more than once if the business case contains multiple funding sources.

There are eight reserves where the funding source is unclear, six of which have no business case developed. The remaining two, the MetroPark Parkade Reserve (Q125) and the Ferry Replacement Reserve (Q129), are not tied to a specific business unit and do not have a funding source specified.

There appears to be little rationale provided in the business cases to support the source of funding. For example, the OAG questions the funding from Fiscal Services for the following reserves as their purposes seem to be business unit specific:

- the DNA Reserve (Q316) - Police
- the Police Vehicles and Equipment Reserve (Q205) - Police

<sup>8</sup> Fiscal Services, "includes HRM's financial responsibilities and obligations that are not directly related to a specific Business Unit" (Proposed Operating Budget 2015/16). Fiscal Services is now referred to as Corporate Accounts in the most recent budget books. For consistency, the OAG has used Fiscal Services throughout this report.

- the Fire and Emergency Service Vehicles and Equipment Reserve (Q206) - Fire and Emergency Services

The reserve business cases provide no clear explanation for the source of funds, so it is unclear to the OAG why some are funded through Fiscal Services and some through specific business units. When reserves are used by a particular business unit but funded by Fiscal Services, it adds a level of complexity to the budget and decreases the transparency to the public. For example, It becomes difficult to determine the full cost to provide Police or Fire services. This failure to properly allocate costs has been identified in other OAG reports and is of concern as without knowing the full costs to provide HRM services it is difficult for HRM Administration to effectively make decisions relating to the operations of the Municipality and the services it provides. It is also difficult for the average taxpayer to make appropriate judgements as to the value of tax dollars expended.

#### Funding from Fiscal Services

In total, of the 53 business cases reviewed, there are only 33 reserves whose business case contains a specific yearly amount to be transferred to reserves. This leaves staff to make decisions each year on how much should be allocated to each of the remaining reserves prior to presenting the budget to Regional Council. Furthermore, of the 15 reserves with funding from Fiscal Services (as shown in Exhibit 4), only four have specified yearly transfer amounts indicated in the business case. When questioned about the process of allocating funds from Fiscal Services for the remaining 11 reserves, staff indicated if there is no set amount provided in the business case, the allocation is determined through the creation of the Fiscal Services budget by the Manager of Financial Policy and Planning in consultation with the Director of Finance. Since it appears allocations are being made annually based on available funds, it is not clear whether the amount allocated is sufficient to satisfy the reserves' purposes or whether 'extra' funds are being added to the reserves. The OAG is concerned there is a lack of transparency for what is going into reserves from fiscal services.

**It is not clear whether the amount allocated is sufficient to satisfy the reserves' purposes or whether 'extra' funds are being added to the reserves.**

## Reserves Funding Other Reserves

As noted in Exhibit 4, there are eight reserves whose business cases outline a source of funds as being from other reserves; six reserves were allocated funds from other reserves as an initial funding source, whereas the other two reserves have transfers from another reserve as their ongoing funding source:

- the Culture Development Reserve (Q312) receives a 10% transfer from the Sale of Capital Assets Reserve (Q101) from all properties sold and
- the Titanic Commemorative Reserve (Q317) receives an annual transfer of \$25,000 from the Culture Development Reserve (Q312).

It is interesting to note, the business cases for the reserves where funds are being transferred from do not list inter-reserve transfers as an intended use of the funds. This is of concern to the OAG as it decreases the transparency of reserves management, as funds can seemingly be reallocated regardless of the original intent. The OAG noted the Culture Development Reserve (Q312) is an operating reserve receiving funding from a capital reserve. In this instance, not only are funds set aside for capital purposes being moved to an operating purpose, there are also strict guidelines in regards to capital reserves in the HRM Charter. According to the HRM Charter Section 120 (4) “A withdrawal from the capital reserve fund shall be authorized by the Council, by resolution, and may only be used for

- (a) capital expenditures for which the Municipality may borrow;
- (b) repayment of the principal portion of capital debt; and
- (c) landfill closure and post closure costs.”

The HRM Charter also specifies the capital reserve fund includes funds received from the sale of property.

The 10% transfer to the Culture Development Reserve (Q312) does not fit into any of these prescribed categories; therefore, it is the view of the OAG this transfer is likely in violation of the HRM Charter.

**The Culture Development Reserve does not fit into any of these prescribed categories; therefore, it is the view of the OAG this transfer is likely in violation of the HRM Charter.**

### Funding for Reserves without a Business Case

Without an approved business case, there is no guidance to or from Regional Council of where the funding should come from or at what level the reserve should be funded. When asked about how the determination is made for funding reserves without business cases, staff informed the OAG the business units determine their contributions to reserves from their operating budget and inform staff in FICT who allocate funds in the reserve budget. According to staff, these funds cannot be withdrawn until the business case is drafted, and

“if [a business unit] needs to access the funds prior to the business case being approved by Council, the report to council acknowledges this and that the business case is pending”.

**Without an approved business case, there is no guidance to or from Regional Council of where the funding should come from or at what level the reserve should be funded.**

However, the OAG found this is not true in the case of the 5594-96 Morris Street Reserve (Q112), which has been in place without a business case since 2006. While it is a small reserve, it is funded and used throughout the year without a business case or approval from Regional Council.

In the view of the OAG, there is a lack of full transparency in regards to the funding of reserves. The business cases do not always specify an amount to be allocated and, for many reserves, there is a lack of support for where funding is to be allocated from. The lack of controls around reserve funding could impact staffs' ability to plan and manage the reserve funds as there is no way to know if reserves are adequately funded in regards to their purpose. This leaves the OAG to question how HRM Administration can ensure effective stewardship of funds if there is no clear direction from Regional Council to guide reserve funding and it is not clear this is the wish of current taxpayers as voiced through their elected representatives.

### Targeted Level of Funding

According to the GFOA, reserves should be established for specific purposes and the business case supporting each reserve should outline details regarding the setting of minimums and maximums for each reserve or at least a targeted level of funding. The Financial Reserves Administrative Order

supports this practice as it requires all reserve business cases to identify “a maximum and minimum balance which should be set to meet the purpose of the reserve”. Out of the 53 reserve business cases reviewed, only 20 have specific minimums, maximums and/or targets and none have all three. It is the view of the OAG this presents a risk to the Municipality as without a stated target (minimum and maximum funding amount), HRM staff have no guidance from Regional Council as to what level to fund reserves. This, in addition to the unspecified yearly funding amounts, could result in a reserve being over or underfunded in relation to its purpose.

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**Out of the 53 reserve business cases reviewed, only 20 have minimums, maximums and/or targets and none have all three.**

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It is also concerning to the OAG, some reserves with stated minimum or maximum funding amounts seem like suggestions, such as in the Operations Stabilization Reserve (Q308) business case which states “It is recommended that future contributions be made until the Reserve reaches a maximum of \$1,000,000 in available dollars”. It is concerning to the OAG the approved business cases for reserves can contain recommendations; it is not clear who is making the recommendations and who they are intended for.

Even when reserves have a stated minimum or maximum funding amount, most have no clear rationale to support the stated amount in the business case. This is of concern to the OAG as there is no support, documented in the business case, showing a thorough evaluation of future needs requiring a particular reserve or how a decision to fund to a specific level for a designated purpose was made. For example, the Snow and Ice Control Variable Operating Reserve (Q309) has a minimum and maximum equal to 10% and 25%, respectively, of the past five year’s average of the actual Snow and Ice Control expenditures. There is no indication how the percentage calculations were created.

For the small number of reserves which have minimums or maximums, the OAG found there are limited instructions on how to proceed when the reserve becomes over or underfunded; in fact, only six reserves had any instruction at all. As noted earlier, the Snow and Ice Reserve business case states “the balance shall not exceed 25% of the average of the five most recent fiscal years snow and ice control costs”. Given this maximum, the Snow and Ice Reserve has historically been overfunded based on the formula. It is unclear how the reserve became overfunded and there were no instructions on how



to proceed. It is also unclear to the OAG if the stated maximums include interest earnings and could therefore be a contributing factor in the case of overfunded reserves.

The OAG believes without minimums and maximums or procedure for dealing with over or underfunded reserves, staff's ability to plan and manage funding of reserves becomes more difficult, as there is no guidance as to what level of funding is sufficient. HRM Administration have accepted the need for this type of control for reserves by requiring minimums and maximums for reserve business cases under the Financial Reserves Administrative Order, yet the number of reserve business cases meeting this criteria is very limited.

**Without minimums and maximums, staff's ability to plan and manage funding of reserves becomes more difficult, as there is no guidance as to what level of funding is sufficient.**

#### Review Process for Reserves

The Financial Reserves Administrative Order specifies "the Director of Finance shall:

- (a) review the active Reserves annually to ensure that funds are contributed and withdrawn according to the approved Reserve Business Case, relevant policies of the Municipality, and accounting policies;
- (b) review each Reserve at set intervals to ensure continuing relevance and adequacy with the strategic direction of the Municipality;
- (c) provide to the Council an annual report on Reserve activity and balances; and
- (d) recommend to the Council the closure of any Reserves whose purpose is outdated or to combine any Reserves with similar purposes."

The supporting Corporate Guidelines for Reserves specify "Business Case and Account Review

- 1) The CAO will provide Council with an annual report as to the status of all reserves including their current relevance and their ability to meet their intended purpose.
- 2) Annually a projection of Reserves will form part of the Operating and Capital Budgets.
- 3) At a minimum, active reserves will be reviewed annually by Accounting to ensure that funds are contributed and withdrawn

according to the parameters of the approved business case, relevant municipal policies, and accounting principles.”

**“The CAO will provide Council with an annual report as to the status of all reserves including their current relevance and their ability to meet their intended purpose.”**

It is not clear if all reserves require a review. Both the Financial Reserves Administrative Order and the Guidelines refer to a review of ‘active reserves’. The definition of an ‘active reserve’ is not clear to the OAG; whether all open reserves are considered active or only when funding is withdrawn or contributed throughout the year.

According to staff the annual review is done on a limited basis and is done by staff in FICT who review each reserve when developing the budget to ensure the contributions match the business cases and withdrawals match the intended purposes of reserves. Any issues or concerns are submitted to the Director of Finance, Manager of Financial Policy and Planning and Financial Consultant of Capital Budget Planning with any discrepancies being approved by the Director of Finance.

According to FICT staff “there has not been a formal review of all reserves”. The only review outside of the budgeting process was the ‘Ten Year History of Reserves’ Report presented to Regional Council in January 2013 as an information item. There is currently a review of reserves taking place but as previously mentioned the scope of this review is not clear.

**According to staff “there has not been a formal review of all reserves”.**

The OAG believes requiring each reserve to be reviewed on a regular basis, to ensure the purpose is still relevant and the target funding level and source is still appropriate, is a good control practice. The old reserve policy, new Financial Reserves Administrative Order and Corporate Guidelines for Reserves call for regular reviews of reserves. Although the Corporate Guidelines specify a review of active reserves on an annual basis, the Financial Reserves Administrative Order only requires a review at ‘set intervals’. Certain reserve business cases also provide set intervals for review; however, it is unclear if these satisfy the Financial Reserves Administrative Order. Some business cases call for an annual review, others have five to ten year review

requirements and 13 have no review instructions at all. This variation between business cases, the Financial Reserves Administrative Order and the Corporate Guidelines could lead to confusion among staff or Regional Council in regards to the review and closure of reserves.

The OAG believes it is unclear if the review includes any involvement from the business units. Although different business units have authority over and set the funding amount for select reserves, it is not stated whether they are involved in the review process. The OAG questions how the CAO or staff in FICT can review the reserves without input from the business units who may have initiated the reserve in the first place.

The OAG has been made aware FICT staff have recently begun a detailed review of reserves; however, the need for a review was identified in January 2013. It is difficult to conclude the review of reserves has been made a priority in HRM which is concerning to the OAG as it presents a risk to the Municipality when considering the impact of reserves on the budgeting process and the role they play in funding decisions. Without a proper detailed review of reserves the OAG questions how HRM Administration and Regional Council can make strategic decisions on when to establish a new reserve, when to contribute funds to existing reserves or which reserves to close.

**The OAG questions how decisions are made on when to establish a new reserve, when to contribute funds to existing reserves or which reserves to close.**

### Closure Process

According to the GFOA, reserve funds should be set aside for specific purposes. The OAG believes the purpose should not be for an indefinite period of time, other than the one capital reserve fund required by the HRM Charter. Therefore, remaining reserves should have clear and specific closure processes. Fourteen reserve business cases provide an approximate timeline with an approximate end date for the reserve; the remaining reserves are either permanent, ongoing or have no business case. There is no clear process for closing out any of the reserves. According to FICT staff, the HRM Operating Budget states each reserve's purpose, when it started and if it is being closed during the year (this is done in order to make Regional Council aware of reserve closures). There is also no process to re-allocate the remaining funds of a reserve being closed and no requirement for this to be presented to Regional Council. During the period of review the OAG observed a closed

reserve had its remaining balance transferred to another reserve without any direction from Regional Council.

**During the period of review the OAG observed a closed reserve had its remaining balance transferred to another reserve without any direction from Regional Council.**

The OAG questions why Regional Council's role is not greater in reserve closures, considering their large role in the establishment of reserves. Without a specified closure process or timeline for reserves, the OAG questions if the Municipality requires the number of reserves which currently exist and at the present funding levels.

**Recommendations:**

- 3.0.1 The OAG recommends HRM Administration ensure each reserve follows the Financial Reserves Administrative Order by having an approved business case before any funding or use of the reserve is allowed.
- 3.0.2 The OAG recommends HRM Administration review all reserves and ensure each is for an appropriate, specific purpose and close or combine any overlapping reserves.
- 3.0.3 The OAG recommends HRM Administration ensure when any new reserve is created it is unique and the purpose could not be satisfied using an existing reserve or could not be considered an ongoing operating expense and therefore not appropriate for reserve funding.
- 3.0.4 The OAG recommends HRM Administration ensure all reserve business cases have a specific funding source(s), supported by a calculation to fund to a specific level.
- 3.0.5 The OAG recommends HRM Administration ensure the funding source is clearly supported, including matching to specific business units when applicable.
- 3.0.6 The OAG recommends HRM Administration ensure each reserve business case has a specific targeted funding level, including a minimum and maximum funding amount and have these amounts are evaluated on a regular basis to ensure they are sufficient given the purpose of each reserve.

- 3.0.7 The OAG recommends HRM Administration ensure there are clear instructions for how to proceed when a reserve is over or underfunded according to its' minimum or maximum. This includes whether or not interest can be allocated to reserves when overfunded.
- 3.0.8 The OAG recommends HRM Administration develop and document a formal review procedure, including a presentation to Regional Council on the current status of all reserves. It is also recommended HRM Administration ensure any review procedure is comprehensive.
- 3.0.9 The OAG recommends HRM Administration ensure all reserve business cases include a detailed timeline which would outline the expected contributions and withdrawals over the life of the reserve, with a clear closure process, especially when reserves are not permanent in nature.

### 3.1 Inadequate Use of Accounting Controls

As was previously mentioned, the Financial Reserves Administrative Order and Corporate Guidelines for Reserves represent a form of internal control to effectively manage reserves. Part of this control is built into the creation of reserve business cases. The OAG would expect to find sufficient accounting controls in place, supporting the Financial Reserves Administrative Order, to ensure appropriate funding sources are used to fund specific reserves and to ensure the expenditures from the reserves are as specified in the business case. The OAG reviewed the approval process for reserve funding and withdrawals, from an accounting controls perspective, to ensure integrity of financial information for reserves and accuracy of reserve reports available to Regional Council and taxpayers.

According to the Financial Reserves Administrative Order and Corporate Guidelines for Reserves, requests for reserve funding or withdrawals must be approved by Regional Council. According to the guidelines, this can either take place during the budgeting process or by a resolution of Council throughout the year.

#### Initiation of Reserve Withdrawals

Some business cases clearly specify an approval process for the release of funds, including who is responsible for the initiation of a withdrawal. For example, the business case for the Regional Facilities Expansion Reserve

(Q145) outlines an in-depth approval process, with clear steps and authorities. However, many reserve business cases do not include a clearly outlined approval process for withdrawals. For example, many business cases state the following as the approval process:

“Financial Services is responsible for ensuring availability of funds and appropriateness of expenditure prior to Council approval. These approvals are primarily done through the annual budget process or on an individual basis prior to being approved by Council.”

According to the reserve business cases reviewed, most reserves have specific authorities for initiating withdrawals; many of these reserve business cases state a withdrawal must be initiated by the Deputy CAO or director of a business unit, whereas, others state the initiation must be done within a business unit, without specifying the director. Some reserve business cases do not outline any approval process, such as the Snow and Ice Control Variable Operating Reserve (Q309).

The OAG is not clear why some business cases seem to need an in-depth process to access the reserve funds while others do not. It would seem all reserves should be subject to the same level of controls since taxpayer funds are taxpayer funds. The OAG is concerned there is no documented standard process to access reserve funds.

### Confirming Availability of Funds

Most reserve business cases state once a withdrawal is initiated, FICT staff are responsible for ensuring availability of funds and appropriateness of expenditures prior to presentation to Regional Council for approval. According to staff, this check is done by a single person in FICT. This responsibility is not outlined in the Financial Reserves Administrative Order or in the supporting Corporate Guidelines for Reserves and is not always listed in the reserve business cases. Though a good practice, it is concerning to the OAG, the procedure is not formalized in documentation; therefore there is no requirement to ensure the control is consistently applied. It is the view of the OAG this practice is also insufficient for reserves without a business case as staff have no guidance from Regional Council to confirm the appropriateness of the requested withdrawal.

### Tracking Reserve Balances and Commitments

Once a withdrawal of reserve funds has been approved by Regional Council, whether globally through the budgeting process or through a specific resolution of Council, these funds can be transferred out of the reserve immediately or withdrawn slowly throughout the fiscal year, up to the approved amount.

In order to track available reserve funds and commitments, staff in FICT maintain a record of reserves in manually updated spreadsheets. These spreadsheets are used to track commitments from reserves, ensure reserve funds are not withdrawn until required by the business unit and ensure no reserve funds are allocated without approval from Regional Council. To ensure consistency of reserve data, transactions within the spreadsheets are matched to SAP by staff in FICT. These spreadsheets are also used to create the summary of reserve reports presented to Regional Council in the quarterly financial reports and the budget. These spreadsheets require diligence by FICT staff to ensure reserve funds are monitored effectively and do not become over-allocated, etc. Staff also monitor Regional Council meetings to ensure all mentions of reserves have been reviewed by FICT and included in the spreadsheets. This is a very manual process which is highly susceptible to errors. There does not appear to be a review process ensuring all transactions are being accurately recorded and reflect the wishes of Regional Council.

According to the Corporate Guidelines for Reserves which support the Financial Reserves Administrative Order, each reserve is also funded by interest on the balance of the reserve. The spreadsheets in FICT are also used to track interest earnings for each reserve. This interest calculation is completed monthly and based on the rate supplied by the Treasurer. The OAG reviewed reserve accounting and was pleased to note interest is being added to accounts on a monthly basis.

### Accounting Error Detection and Correction

According to Section 14 of the Financial Reserves Administrative Order:

“Management of Reserve balances and correction of errors may be approved by the Director of Finance, within the parameters of Council’s direction as set out in the approved Reserve Business Case.”

The Corporate Guidelines for Reserves states:

“Any corrections or strategic amendments shall be

recommended to the proper approval authority. Correcting transactional errors or transfers of fund balances to manage minimum/maximum thresholds can be approved by the Director of Finance, as a designate of Council's approved direction within the parameters of the business case. Unclear direction or transactions in conflict with Council's previous direction require Council's approval."

According to staff in FICT, 'professional judgement' is used to determine if a transactional error needs a simple housekeeping correction. If it is determined an error simply needs a housekeeping correction, it is reversed by staff without seeking Regional Council approval as is specified in the Financial Reserves Administrative Order. The OAG is not confident all transactional errors are identified as there was an instance during the OAG review where an apparent error was left undetected and uncorrected. During 2013 in the establishment of the Regional Facilities Expansion Reserve (Q145) Regional Council approved \$1 million to be allocated from the Operations Stabilization Reserve (Q308) however, in reality \$2 million was transferred. Therefore, an extra \$1 million was transferred which was not approved by Regional Council. The OAG could not see evidence of any correction during the review period. It is the view of the OAG, HRM Administration is lacking a strong enough control for identifying and reversing transactional errors.

**The OAG is not confident all transactional errors are identified as there was an instance where an apparent error was left undetected and uncorrected.**

### Financial Statement Reporting

The OAG believes effective accounting controls for reserves should result in consistent, accurate reporting of reserves information. The OAG expected to find consistency in reserves reporting across budget documents, quarterly reports, other Regional Council reports and HRM Financial Statements. The OAG cross-checked the year-end spreadsheet balances for each year of the review to the financial statements and noted the amounts did not agree. According to staff, the majority of this variance can be attributed to the Mengoni Landfill, which has no reserve but is treated as a reserve and added to the balances on the Financial Statements, but not to the reserves spreadsheet or other HRM reports. The Mengoni Landfill is recorded as a liability in the HRM general ledger. The remaining variances are attributable to a late adjustment due to a change in the projects funded by the gas tax in



2011 and a late adjustment due to an increase in the Metro Centre anticipated surplus in 2013.

The HRM Charter specifies in Section 120 (3) (g) The capital reserve fund includes the current fiscal year's accrual for landfill closure and post closure costs which would indicate to the OAG the Mengoni Landfill accruals should be included in the capital reserve fund, not as a liability in the general ledger. When questioned, FICT staff noted the Mengoni Landfill was much smaller in comparison to HRM's major landfills and therefore the business unit responsible felt a balance sheet account would suffice, rather than a reserve. While the OAG acknowledges the balance is in fact small, it is still a question of control. It is concerning to the OAG there is no control to ensure all funds which are required to be deposited into the capital reserve fund, according to the HRM Charter are, in fact, deposited.

Furthermore, adjustments made at year end for financial statement reporting should flow through to the following year's reserves spreadsheet in the beginning balances of the ongoing reporting to Regional Council. However, the OAG noted the reported ending balances as presented in the year-end audited financial statements were never carried forward to the beginning balance of the following year but the differences were recorded as unplanned transactions and summarized in transfers in/transfers out in the next year's quarterly reporting spreadsheets.

As stated previously, there was a late adjusting entry during the external audit of the 2011 year-end financial statements due to a change in the committed funds for projects from the Gas Tax Reserve (Q134). There is a specific agreement between the Province of Nova Scotia and the Municipality which governs the use of funds from the Gas Tax Reserve. It is concerning to the OAG the required adjustment was only made when HRM's external auditors determined the approved projects did not meet the terms of the agreement and current accounting controls did not prevent the projects from receiving initial approval. There should be a control for ensuring projects not only meet the requirements of a reserve business case, but also any applicable agreements. There should also be a process to monitor changes to various agreements to ensure uses of restricted funds are appropriate.

#### **Accounting Controls to Verify Reserve Activity Against the HRM Charter**

The HRM Charter is a legislative control for reserves, specifically for the capital reserve fund. It is not clear to the OAG if there is an internal accounting control to ensure withdrawals from reserves meet the restrictions as outlined

by the HRM Charter or how often the Charter is consulted when transferring funds in and out of reserves. It appears the HRM Charter is consulted during the creation of a reserve business case, but once created only the business cases are consulted for funding decisions. It would appear however, there are situations where even business cases seem to contradict the HRM Charter. The HRM Charter specifies in Section 120 (4) "A withdrawal from the capital reserve fund shall be authorized by the Council, by resolution, and may only be used for

- (a) capital expenditures for which the Municipality may borrow;
- (b) repayment of the principal portion of capital debt; and
- (c) landfill closure and post closure costs."

During the review, the OAG found examples of capital reserve funds being transferred for purposes not outlined by the HRM Charter, such as:

- Seven closed capital reserves in 2014/15 with remaining funds transferred to an operating account in Fiscal Services.
- The source of funding for the Culture Development Reserve (Q312), which is an operating reserve, is the Sale of Assets Reserve (Q101), which is a capital reserve. (Other inter-reserve transfers will be discussed in detail further in the report.)
- Funding for the 2014/15 general rate deficit from two capital reserves; the Waste Resources Reserve (Q123) and the Sustainable Communities Reserve (Q127). (The 2014/15 general rate deficit will be discussed in detail further in the report.)

Section 120 (4) indicates capital reserve funds are to be used for capital purposes therefore, the OAG believes the above transfers to operating accounts and operating reserves are potentially in violation of the HRM Charter.

## Conclusion

The OAG found HRM staff may have deviated from policy in the management of reserve funds and have not formalized many of their practices. It is concerning to the OAG, the current controls do not appear to ensure the movement of capital reserve funds are always in accordance with legislation. The OAG is concerned there is a risk the internal accounting controls for reserves are not strong enough to ensure effective management of reserve funds.

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**The OAG is concerned there is a risk the internal accounting controls for reserves are not strong enough to ensure effective management of reserve funds.**

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**Recommendations:**

- 3.1.1 The OAG recommends HRM Administration develop and document a standard process to access reserve funds.
- 3.1.2 The OAG recommends HRM Administration ensure all reserves have clearly documented authority which matches the purpose of the business case and reserves policy.
- 3.1.3 The OAG recommends HRM Administration document the current process of ensuring availability of funds for unplanned transactions and ensuring they are in accordance with the purpose of the reserve as stated in the business case.
- 3.1.4 The OAG recommends HRM Administration formalize and document reserve accounting controls in regards to:
  - a. ensuring the approved funds are transferred to and from reserves and
  - b. ensuring all errors can be easily identified and corrected on a timely basis.
- 3.1.5 The OAG recommends HRM Administration ensure all reserve reporting is consistent; specifically, Fourth Quarter Financial Reports and beginning balances of the reserve reports agree to audited financial statements.
- 3.1.6 The OAG recommends HRM Administration implement and document stronger controls around ensuring reserves and reserve fund transfers are allowed under the applicable legislation.
- 3.1.7 The OAG recommends HRM Administration provide legal advice to Regional Council to interpret the HRM Charter in regards to the guidelines for the capital reserve fund and the use of capital reserves.

#### 4.0 Lack of Clarity/Transparency in Reporting on Reserves

As was mentioned previously, the HRM Charter assigns responsibility for reserves to Regional Council. Regional Council is tasked with determining the purpose for establishing each reserve and ensuring the reserves are effectively managed. It is the view of the OAG, transparent and understandable reporting is an essential control for the effective management of reserve funds and to demonstrate good stewardship of funds. The OAG identified the reporting requirements for reserves from the Financial Reserves Administrative Order and the Corporate Guidelines for Reserves. The OAG then reviewed the information being provided to Regional Council for clarity and effectiveness for decision making purposes.

**Transparent and understandable reporting is an essential control for the effective management of reserve funds and to demonstrate good stewardship of funds.**

Reserves are reported to Regional Council in a variety of ways, through the regular operating budget process, quarterly financial reports and individual reports to Council. The HRM Charter requires any withdrawals from reserves to be approved by a resolution of Council. Regional Council approves the operating budget which includes the reserves contributions and expenditures which are spread amongst the business unit detail of the budget. These are considered 'planned' transactions.

Any additional expenditures or withdrawals from the reserve funds not included in the budget process (these are considered 'unplanned' transactions) must be approved separately through a resolution of Council. This process involves a report first to Audit and Finance Standing Committee and then, if recommended, a report is forwarded to Regional Council for approval.

The OAG reviewed in detail the different reports used for reserves reporting and the specific information provided by each report.

#### Operating Budget

Reserves are presented within the operating budget in a number of places.

- Each business unit as well as Fiscal Services discloses general ledger account 8008 Transfers to/from Reserves in their detailed budget information. This is the net amount each business unit intends to

receive or contribute to a reserve and is included as part of the 'Other Fiscal' summary.

- Also included in the budget is a separate reserves overview outlining all reserves with a brief description of their purpose and an indication if they have a business case or not. This overview also includes a summary of the individual reserves opening balances, budgeted contributions, withdrawals and interest. FICT presents this overview as well as the previously mentioned Fiscal Services section to Regional Council as part of their budget presentation.

A significant amount of funding for reserves comes from Fiscal Services. Since these contributions (transfers) are included as expenditures for the year, in the view of the OAG, it is difficult to identify the true costs to provide specific services of HRM. It is not clear how much it costs to conduct the operations of each specific business unit of the Municipality and how much funding is being transferred to or from reserves being included in the operations. The budget includes the transfers to/from reserves in the 'other fiscal' summary line item for the business units as well as Fiscal Services; \$17 million and \$15 million was budgeted to be transferred to reserves for 2014 and 2015 respectively. Transfers to and from reserves are not being clearly isolated in the expenditures of the Municipality and without business cases, funding targets and clear purposes for these reserves; it is difficult to monitor the effectiveness of reserves.

**Without business cases, funding targets and clear purposes for these reserves; it is difficult to monitor the effectiveness of reserves.**

The level of detail included in the operating budget is high-level which caused the OAG to request the supporting calculations for the budgeted information. Staff in FICT maintain detailed spreadsheets in support of both the budget and quarterly reports. These spreadsheets track budgeted contributions, withdrawals and commitments as well as incorporate any unplanned withdrawals or contributions to the reserve funds in order to accurately track pending commitments. The information is updated for the quarterly summary information reports to Regional Council.

#### **Quarterly Financial Reports**

The quarterly financial report provided to Regional Council includes, for each individual reserve, the opening balance, a summary of transfers in and

transfers out, the current balance as well as a summary of pending expenditures and contributions. These items are totaled into the net available balance of the reserve, compared to the budgeted available balance and the projected variance calculated. This report includes unplanned transfers in and out of reserve for the quarter in the totals but does not identify them as unplanned.

The reserves report is presented initially as an attachment to the quarterly financial report to Audit and Finance Standing Committee. The financial report is then presented as an information item to Regional Council as a memorandum from Audit and Finance Standing Committee. There is little opportunity for Regional Council to discuss the performance of reserves as the information presented to Regional Council is as an information item and the reserve report is an attachment within this detailed report. The information in the reserve report does include variances but does not isolate the variances caused by unplanned transactions. Therefore, it is difficult for Regional Council to identify the impact of unplanned transactions on the performance of the reserves.

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**It is difficult for Regional Council to identify the impact of unplanned transactions on the performance of the reserves.**

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### Council Reports

In accordance with the Financial Reserves Administrative Order, the establishment and closure of reserves as well as withdrawals from reserves which are not included in the budgeting process are to be approved through a resolution of Council. The recommendations to approve the establishment of a reserve fund or to approve an unbudgeted withdrawal from the reserves are initially taken to Audit and Finance Standing Committee and, if approved, moved to Regional Council for consideration. There is no standard for what is included in a report to Regional Council on the reserve other than the predetermined report categories. There is a risk, without a standard for reporting on reserves, the information being brought forward is not clear or transparent enough for Regional Council or taxpayers to understand the reason for the unplanned withdrawals from reserves or the impacts on the reserve fund balances.

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**There is a risk the information being brought forward is not clear enough for Regional Council to understand.**

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The OAG is concerned there may not be adequate discussion during Regional Council meetings around how the reserve funds are being used considering the balance in the reserve funds was over \$181 million at March 31, 2015. With this lack of attention being paid to the reserve funds, the OAG is concerned this level of reporting and discussion does not adequately demonstrate good stewardship of funds.

**The OAG is concerned there may not be adequate discussion around how the reserve funds are being used considering the balance in the reserve funds was over \$181 million.**

### Financial Statements

The individual reserve balances are also included in a note to HRM's audited consolidated financial statements. Due to the fact that the financial statements are presented on a consolidated basis, the statements do not identify all reserve transfers. While the OAG acknowledges this is acceptable reporting for the preparation of the consolidated financial statements, the OAG is concerned it may not be transparent enough to the average taxpayer how reserves are funded and used. Although not required by Public Sector Accounting Standards, the OAG believes additional note disclosure would provide greater transparency.

**The OAG is concerned it may not be transparent enough to the average taxpayer how reserves are funded and used.**

### Conclusion

Information on reserves is reported in multiple ways. There is a risk high-level information is not transparent enough to clearly demonstrate the effect the reserve transfers have on reserve accounts or the current or future budgets. Since financial information does not clearly identify all reserve fund activities, it is difficult for the taxpayer to easily understand the true cost to conduct Municipal operations and for Regional Council to make strategic decisions based on the information presented to them.

**Recommendations:**

- 4.0.1 The OAG recommends HRM Administration work with Regional Council to decide what information Regional Council requires to make strategic decisions with regards to reserve funds and have it incorporated into the financial reporting.
- 4.0.2 The OAG recommends HRM Administration set a standard for reporting unplanned reserve transactions to Regional Council which includes the impact to the reserve and the budget.
- 4.0.3 The OAG recommends HRM Administration disclose the transfers to and from the reserves in the financial results of the Municipality.



## 5.0 Lack of Clarity/Transparency in Reporting Unplanned Inter-Reserve Transfers

The OAG reviewed the unplanned transfers from reserves for the period under review. Unplanned transfers are transfers which are not included as part of the annual budgeting process and require a resolution of Regional Council in order to be approved. The OAG observed in fiscal 2012/13 three inter-reserve transfers which were not included in the annual budget process or consistent with the identified use of funds in the reserve business cases. The transfers were as follows:

**Exhibit 5: Inter-reserve transfers in fiscal year 2012/13 outside of the annual budget process.**

Reserve	Transfer out	Description
Operations Stabilization (Q308)(operating reserve)	\$2,000,000	Transfer to Regional Facility Expansion (Q145)(capital reserve) as per council report
Snow and Ice Control Variable Operating (Q309) (operating reserve)	\$5,000,000	Transfer to Regional Facility Expansion (Q145)(capital reserve) as per council report
Operations Stabilization (Q308) (operating reserve)	\$1,000,000	Transfer to Strategic Growth (Q126)(capital reserve)

The OAG reviewed the reports and minutes for Audit and Finance Standing Committee and Regional Council for the 2012/13 fiscal year for support of the unplanned transfers in the table above. The OAG identified a February 27, 2013 report to Regional Council concerning the Regional Facility Expansion Reserve (Q145), which was on the agenda for the March 19, 2013 Regional Council meeting, recommending the transfer of funds out of two operating reserves for the initial funding of a capital reserve, Regional Facility Expansion (Q145).

The funds for the capital reserve were recommended to be transferred from the Operations Stabilization Reserve (Q308) and the Snow and Ice Control Variable Operating Reserve (Q309). The Regional Council motion approved the transfer of \$1 million from the Operations Stabilization Reserve and \$5 million from the Snow and Ice Control Reserve. Instead of the \$1 million approved by Regional Council it appears \$2 million was actually transferred from the Operations Stabilization Reserve. The OAG questions why Regional Council only approved \$1 million of the transfer to the Facility Expansion Reserve when the actual transaction resulted in a \$2 million transfer with no correcting entry.

**The OAG questions why Regional Council only approved \$1 million of the transfer to the Facility Expansion Reserve when the actual transaction resulted in a \$2 million transfer.**

#### **Regional Facility Expansion Reserve (Q145)**

The Regional Facility Expansion Reserve's business case indicates the purpose as:

"The Regional Facility Expansion Reserve is intended to enable HRM to proactively plan for Service Improvement Projects that include major expansion, replacement, renovation, enhancement or new construction of certain Regional Facilities so as to meet changing demographic, service and recreational needs, as determined by Regional Council. This reserve is not meant to provide funds for operating costs, ongoing repairs and maintenance, or address recapitalization which is currently funded through other budget sources. Expenditures from the reserve must be supported by a solid business case."

The reserve is classified as a capital reserve while the two reserves which provided it with initial funding are classified as operating reserves. The OAG questions the rationale for transferring funds classified as operating into a capital reserve when there is no apparent connection to the purpose or support for the decision. This calls into question the decision making process in that an operating need has suddenly become a capital need.

**The OAG questions the rationale for transferring funds classified as operating into a capital reserve when there is no apparent connection to the purpose or support for the decision.**

#### **Snow and Ice Control Variable Operating Reserve (Q309)**

Before the recommendation to transfer funds to the Facility Expansion Reserve was approved at Regional Council it went through Audit and Finance Standing Committee and was presented with the impact on the reserve balances. At Audit and Finance Standing Committee, one Councillor questioned what the impact would be on the Snow and Ice Control Variable Operating Reserve since the transfer amount was significant. FICT Staff

“advised that the reserve was set up to deal with snow and ice fluctuations and that the reserve is currently overfunded. The fund should have \$5 million but is presently at \$8 million”.

The Snow and Ice Control Variable Operating Reserve business case has specified funding minimums and maximums. The business case states “The balance shall not exceed 25% of the average of the five most recent fiscal years snow and ice control costs”.

The OAG reviewed the Snow and Ice Control Variable Operating Reserve balance and found the balance to be over \$8 million from 2010/11 onward until the transfer in 2012/13. This means the reserve was overfunded and violating the business case restrictions for two years before the recommendation to use the excess funding for the establishment of a new reserve was made.

It is also interesting to note there were operating deficits in the Snow and Ice (Winter Operations) Division exceeding \$5 million for the 2008/09 to 2011/12 fiscal years yet no funds were transferred from the Snow and Ice Control Variable Operating Reserve in support of these deficits, being the specified purpose of the reserve. It appears funds were not transferred because an overall operating surplus within HRM existed and could sufficiently cover the deficit in the division. The OAG questions the rationale behind leaving the Snow and Ice Control Variable Operating Reserve overfunded for at least two fiscal years prior to any recommendation to Regional Council on reducing the funding level.

#### **Operations Stabilization Reserve (Q308)**

The OAG identified the purpose of the Operations Stabilization Reserve as:

“Many regular operating expenditures fluctuate from year to year based on demand for the service. Occasionally, an unusual fluctuation occurs which is significantly greater than the normal expenditure pattern and which cannot reasonably be covered within available funding. The Operations Stabilization Reserve can be used to smooth significant fluctuations in expenditures which cannot be anticipated and are beyond the control of the organization.”

The application of funds reads as follows:

“Funds can be used to smooth the impact of any core municipal service expenditure which arises as a result of a fluctuation that could not be reasonably anticipated, avoided

or managed within the remaining operating budget of the business unit affected.”

In the view of the OAG, transferring funds to the Regional Facilities Expansion Reserve from the Operations Stabilization Reserve does not fit the approved purpose or application of funds as outlined in the reserve business case.

As Exhibit 5 indicates, during 2012/13 there was also an inter-reserve transfer from the Operations Stabilization Reserve to the Strategic Growth Reserve (Q126). The OAG did not find an accompanying report to Regional Council for this transaction. The OAG reviewed the Corporate Guidelines for Reserves and found the Director of Finance is authorized to transfer reserve funds without a resolution of Council, as a designate of Regional Council’s approved direction within the parameters of the business case, if a reserve has become overfunded.<sup>9</sup> While the Operations Stabilization Reserve was overfunded at the time of the transfer to the Strategic Growth Reserve, the \$1 million transfer did not result in the fund balance being brought below the funding maximum. The maximum stated for this reserve is \$1 million and even after the transfers took place the reserve remained overfunded. The OAG concludes in light of the business case issues outlined above, the authorities of the Director of Finance do not appear to be explicit enough in the Financial Reserves Administrative Order.

It is interesting to note this reserve was also overfunded for the previous two years of the review period and the two transfers in 2012/13 totaling \$3 million did not bring the reserve below the \$1 million threshold. The OAG found there was no discussion around why the reserve had become overfunded or why the \$3 million excess should be transferred to the two capital reserves.

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**The OAG found there was no discussion around why the reserve had become overfunded or why the \$3 million excess should be transferred to the two capital reserves.**

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Upon further review, the OAG noted the Operations Stabilization Reserve remained overfunded until an unplanned transfer of approximately \$600,000, described as overages and approved by the Director of Finance, was made in 2014/15. The funds were once again transferred to a capital reserve, Capital Surplus Reserve (Q103), and again there was no support as to why these

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<sup>9</sup> Financial Reserves Administrative Order paragraph 14 - Management of Reserve balances and correction of errors may be approved by the Director of Finance, within the parameters of Council’s direction as set out in the approved Reserve Business Case.

funds should be transferred to this specific reserve at this time. The OAG is concerned this practice of leaving reserves overfunded for extended periods of time may cause them to be perceived as a parking lot for excess funds.

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**The OAG is concerned this practice of leaving reserves overfunded for extended periods of time may cause them to be perceived as a parking lot for excess funds.**

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## Conclusion

It is concerning to the OAG, funds can be moved out of reserves for purposes which the OAG views as not consistent with the approved reserve purpose. Reserves are established for specific purposes; these purposes being deemed important by Regional Council for the financial sustainability of the Municipality. The funding source of these reserves is, of course, the taxpayer and they need to be confident when a need is presented and their funds are used, the need is clear and justified. The OAG understands it is acceptable for reserve funds to be reallocated based on strategic direction from Regional Council but there is no evidence of this direction being consistently given.

It is also concerning to the OAG reserves can become significantly overfunded for two fiscal years before any action is taken, as this is money which could be reallocated for other purposes or perhaps reductions in the general tax rate could be affected. If Regional Council was made aware of the amount of overfunding in the reserves then a strategic decision could be made as to how to proceed with reallocation but in the current practice Regional Council is only made aware of the overfunding when a recommendation to transfer the funds is being proposed. These transfers are also unplanned and not included in the regular budgeting process so it is difficult to conclude there is always effective budgeting taking place. The OAG believes Regional Council should be given an opportunity during the budgeting process to reallocate any excess funds from any overfunded reserves.

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**The OAG believes Regional Council should be given an opportunity during the budgeting process to reallocate any excess funds from any overfunded reserves.**

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**Recommendations:**

- 5.0.1 The OAG recommends HRM Administration report the amount of overfunding by reserve to Regional Council as a part of the annual budgeting process so there can be discussion around the appropriate re-allocation of these funds.
- 5.0.2 The OAG recommends HRM Administration provide documented support for a recommendation to transfer reserve funds for a purpose inconsistent with the reserve's approved business case.
- 5.0.3 The OAG recommends HRM Administration clarify the authorities of the Director of Finance in the Financial Reserves Administrative Order.

### 5.1 Lack of Discussion by Regional Council of Impact of Reserve Transfers to Fund General Rate Deficit

As a result of increased expenditures in snow and ice operations, the Halifax Transit fuel spill and a reduction in the deed transfer tax in fiscal 2014/15, HRM was faced with a general rate deficit. To cover the deficit, HRM Administration recommended to Regional Council a number of transfers out of reserve accounts to the operating fund; Regional Council approved this recommendation and funds were transferred out of five different reserves as shown in the exhibit below.

**Exhibit 6: Unplanned Reserve withdrawals to fund the 2014/15 general rate deficit.**

Reserve	Transfer Out
Waste Resources Capital (Q123)	\$7,978,000
Self-Insurance (Q306)	\$300,000
Snow and Ice Control Variable Operating (Q309)	\$1,700,000
Operating Surplus (Q328)	\$1,714,470
Sustainable Communities (Q127)	\$120,525
<b>Total transferred out of reserves to fund deficit</b>	<b>\$11,812,995</b>

The OAG reviewed the business cases for the five reserves which were used in the transfer of funds. The purposes are outlined below.

**Waste Resources Capital Reserve (Q123):** "To provide funding for the construction of landfill cells and purchase of equipment including replacement carts to operate the waste resources program. Funding to come from the operating budget of Fiscal Services (M316) and from interest paid to the reserve."

**Sustainable Communities Reserve (Q127):** “The purpose of this reserve is to fund environmentally friendly projects, including those which reduce the environmental impacts of municipal operations and community activities. Primary funding to come from interest savings on loans from the Federation of Canadian Municipalities’ Green Municipal Investment Fund and other potential sources are: corporate contributions, public partnerships, and savings produced from reduced reliance on fossil fuels.”

**Self-Insurance Reserve (Q306):** “To provide funds for settlement of insured risks to HRM and to reduce the expenses associated with insurance costs by increasing the minimum deductible provided in HRM’s policy. The costs related to insurance and risk can fluctuate greatly each year. The HRM, at any time, has an amount of claims outstanding. This reserve will provide an amount to stabilize the fluctuation of these costs and reserve monies for outstanding claims. Funding to come from the operating budget of Fiscal Services (M320) and from interest paid to the reserve.”

**Snow and Ice Control Variable Operating Reserve (Q309):** “This reserve provides funding for costs associated with snow and ice control which are beyond that provided for in the annual operating budget. Given the unpredictability of winter weather, it is prudent to plan for the contingency that any one winter may place an onerous burden on the resources of the Municipality. Funding to come from operating budget of Fiscal Services (M471) and from interest paid to the reserves.”

**Operating Surplus Reserve (Q328)<sup>10</sup>:** “As prescribed by the Financial Reporting and Accounting Manual (FRAM), in 2014 any operating surplus must be placed into an Operating Reserve. New Business Case to be developed.”

The OAG found the withdrawals from the Snow and Ice Control Reserve and Self-Insurance Reserve to fund the deficit in line with the purpose stated in the business cases due to the fact that the deficit was primarily driven by a shortfall in winter operations and a fuel spill. The Operating Surplus Reserve however, has no business case to support the transfer. The stated purposes of the other two reserve accounts used to fund the 2014/2015 general rate deficit do not support this resolution. In fact, two of the reserves used are classified as capital and are not intended to be used to fund operating activities, including a general rate deficit.

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<sup>10</sup> Since there is no approved business case for Q328 the purpose listed above was identified in the budget documentation listing of reserves

**The stated purposes of the other two reserve accounts used to fund the 2014/2015 general rate deficit do not support this transaction.**

The OAG questions how capital reserve funds may be used to fund operating shortfalls without discussion. The OAG looked for supporting documentation or discussions within Regional Council around these transfers. The OAG expected to see detailed information around the impact to the reserve balances or plans for replenishment of the capital reserves but could not find any. The minutes from the four meetings (Audit and Finance Standing Committee and Regional Council) where these transfers were presented and approved had no specific discussions around the impact and the motions to approve the transfers were approved unanimously. As previously mentioned, the OAG believes transfers from capital reserves for operating purposes are likely in violation of HRM Charter Section 120 (4).

The reserves listed above were all created and funded for specific purposes; purposes approved by Regional Council. The OAG understands it may be acceptable to withdraw from a reserve for a purpose outside of the business case providing there is adequate discussion by Regional Council around why the funding is being removed. It is concerning to the OAG these discussions do not appear to have taken place and nearly \$12 million was removed from reserve funds with only \$2 million of it appearing relevant to the stated reserve's purpose.

**Discussions do not appear to have taken place and nearly \$12 million was removed from reserve funds with only \$2 million of it appearing relevant to the reserve's stated purpose.**

Exhibit 7 below outlines the impact the transfers had on the specific reserves and their ending balances.

**Exhibit 7: Impact of Unbudgeted Transfers to Fund 2014/15 Deficit.**

Reserve	Reserve Budgeted Net Available Balance	Reserve Balance Before Unbudgeted Transfer	Reserve Actual Net Available Balance	Unbudgeted Transfer to Fund Deficit
Waste Resources Capital (Q123)	\$21,260,570	\$19,739,095	\$11,761,095	\$7,978,000
Sustainable Communities (Q127)	\$457,617	\$349,011	\$228,486	\$120,525
Self-Insurance (Q306)	\$4,225,533	\$4,254,406	\$3,954,406	\$300,000
Snow and Ice Control (Q309)	\$4,419,617	\$4,422,126	\$2,722,126	\$1,700,000
Operating Surplus (Q328)	\$6,028,671	\$8,540,792	\$6,826,322	\$1,714,470

Note: The titles align with terminology used in HRM Quarterly Financial Statements.



It is clear from Exhibit 7 these transfers had a significant impact on the balance of the reserve accounts, compared to the 'budgeted net available balances'. (This balance is the amount Regional Council approves during the budget process.) While the individual unplanned transfers were approved separately by Regional Council there was no discussion around what effect this had on the approved budgeted balance for the funds which do not seem relevant to the items which were said to contribute to the deficit. The variance from the budgeted amounts to the actual amounts is significant and the OAG questions why there was no discussion around this impact especially since the anticipated balances in the reserves, prior to the transfer, had been approved through the budget process by Regional Council as being required. Should these funds not have been needed, one would assume they should have been part of the annual budget discussions and perhaps a reduction in the HRM tax rate could have taken place.

The OAG finds it concerning reserve funds may be used for purposes outside of the stated purpose in the business case without having to establish a replenishment plan or report the impact of the transfer to Regional Council. If these transfers did not, in fact, have an adverse impact to the funding level of the reserves, the OAG questions why reserve funds were allowed to become significantly overfunded and why this was not presented and discussed with Regional Council at the time of the annual budget deliberations.

**Recommendations:**

- 5.1.1 The OAG recommends HRM Administration, when recommending a transfer from a reserve outside of the business case purpose, present a schedule to replenish the reserve, in addition to presenting the impact on the reserve fund. If no replenishment is required, there should be a documented explanation as to why. If the reason is overfunding, a description of how this occurred and how this will be prevented from happening in the future should be included.
- 5.1.2 The OAG recommends HRM staff review if the current reserves and purposes adequately fit the Municipality's current needs and anticipated future needs.

## Appendix A: Management Response

January 11, 2016

Larry Munroe  
HRM Municipal Auditor General  
Belmont House, Suite 620  
33 Alderney Drive  
Dartmouth, Nova Scotia B3J 3A5

**Re: A Performance Review of the Management of Halifax Regional Municipality's Reserve Funds<sup>6</sup>**

Dear Mr. Munroe:

Thank you for your report dated December 22, 2015 where you identify 26 recommendations in relation to:

- the adequacy of policies, procedures and process for the purpose and use of reserve funds;
- the identification for the requirement of a reserve;
- the existence of effective controls and processes for managing specific reserves; and,
- the adequacy of transparent and understandable reporting.

I would like to thank you for recognizing staff's work with regard to the implementation of the new Administrative Order 2014-15-ADM (attached), approved by Regional Council on October 28, 2014. Your recommendations are consistent with much of the policy embodied in this Admin Order, so we are encouraged to continue with its implementation. We agree that the Municipality requires prudent management of reserve funds and believe that Council has provided this direction to staff with this approved Admin Order (updated from December, 1998).

The Administrative Order is being implemented in three phases:

**Phase One:** The first phase of the project has been to determine the types of risks and which risks are appropriately covered by reserves and also provide support for other reserves anticipated in the Admin Order. We are currently nearing the end of this phase.

**Phase Two:** The next phase is to determine the number of reserves required and the funding required of each reserve. Some work has been completed in this phase.

**Phase Three:** The final phase will be to develop a process to administer reserves according to the new administrative order.

As you have noted, the HRM Charter, Section 120(1) provides Council with the authority to maintain a capital reserve and other reserve funds for such purposes as Council may determine. Staff is required to ensure adequate policies and procedures are in place to support Council's direction and further to ensure that reporting is transparent and understandable. One of the ways we ensure this accountability is through the public release of our financial results, accounting and reports.

Your recommendations will be considered as continue to implement Council's Administrative Order 2014-15-ADM, improving our policies, process and reporting.

Sincerely,

**HALIFAX REGIONAL MUNICIPALITY**

ORIGINAL SIGNED

John Traves, Q.C.  
Acting Chief Administrative Officer  
Office of the Chief Administrative Officer

**HALIFAX**

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