

February 3, 2015

Capital Financing Fund and Sinking Fund Audit

Background

Capital Financing Fund:

The main purpose of the Capital Financing Fund (CFF) is to provide internal financing for City capital or other major projects. It also contains the Solid Waste Capital Reserve, which was established to fund the City's portion of liability related to the future closure and post-closure costs of the Vancouver Landfill.

There are currently 42 outstanding loans for projects that are funded by the Capital Financing Fund. The related projects are at various stages of completion, having been initiated as early as 1997 and as late as 2013. There were no additional CFF loans approved for new projects during 2014.

The balance of the Capital Financing Fund as at December 31, 2014 is \$265 million. The uncommitted cash balance, which is the amount of remaining CFF funding available for future City capital projects, is \$59 million. This is up from prior year's balance of \$39 million; fluctuations are due to changes in loan advances and repayments. Council or City Manager approval is required for projects prior to obtaining financing from the Capital Financing Fund, with financing terms at the discretion of the Director of Finance.

Sinking Fund:

The Sinking Fund accumulates installment payments required to retire sinking fund debt at maturity. In contrast to a serial debenture in which portions of the principal amount are due annually, an entire sinking fund debenture matures at the end of the term. Annual installments are set aside and invested so as to accumulate to an amount sufficient to pay back the principal of the debt by the maturity date.

The City issues debentures typically on an annual basis. The amount issued is driven by the annual capital funding requirements, as debt financing is one of multiple funding sources utilized. In 2014, the City issued \$105 million in sinking fund debentures to finance the capital expenditure program.

Sinking Fund transactions that occur throughout the year relate to interest earned on investments held by the fund, transfers of sinking fund installments, and debt repayment at maturity.

As of the end of 2014, the City had external debt outstanding in the amount of \$868.4 million, with \$246 million accumulated in the Sinking Fund for future debt retirement.

Scope

The audit objective was to provide reasonable independent assurance that fund activities are in compliance with applicable legislation, policies, and procedures, and that funds are adequate to meet their intended objectives. For both funds, the audit assessed the adequacy and effectiveness of existing internal controls and efficiency of business processes. Work included:

- Review of related policies and procedures, City bylaws, and Vancouver Charter requirements;
- Review of processes in place to ensure funds are adequately monitored and are used for their intended purposes;
- Review of accounting processes involved to reflect fund activity and current balances; and
- Review of a sample of transactions.

Conclusion

The Capital Financing Fund and Sinking Fund audit was initiated to provide reasonable independent assurance that the business processes and related internal controls are adequate and effective. The audit found that the internal controls over the Capital Financing Fund and Sinking Fund are adequate to ensure that fund activities comply with legislation and existing policy and procedures, that objectives of the funds activities are being fulfilled, and that Sinking Fund reserves are sufficient for debt repayment. However, there is potential for improved internal control and risk mitigation with respect to documentation and policies for Capital Financing Fund loans.

The more significant findings and recommendations, including management's responses can be found below:

- **Formalize the review and reporting process for Capital Financing Fund loans:** Formalizing the review and reporting of the loan repayments and benefits realized by projects funded by Capital Financing Fund loans would enhance oversight and provide management with additional information for decision making. Management has agreed to formalize the tracking and reporting process.
- **Finalize documentation of the Internal Loan Process policy and procedure:** A draft Internal Loan Process policy and procedure document was updated in 2012 but has not yet been finalized, as roles and responsibilities of the departments involved are being determined. Management has agreed to review and finalize the draft document, and will also consider the inclusion of policy statements regarding retention of documentation and projects utilizing multiple funding sources.