Finance - Treasury Operations Audit Report

August 2005

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1.0 Management Summary

Audit Services has completed a risk-based review of the Treasury function at York Region. The risk-based approach to develop the Audit Plan rated the Treasury Branch as a high risk.

The scope of the audit included:

- Liquidity, Funding and Cash Management
- Risk Management
- Treasury Operations
- Finance
- Regulatory
- Systems

Treasury management understands and values the need for appropriate procedures, controls, safeguards and reporting processes relating to the Region's investment and debt functions. The recommendations adopted and implemented as a result of this audit review will serve to enhance and strengthen Treasury programs, and build upon the significant progress and accomplishments made over the past few years.

Some of these developments include but are not limited to the following:

- Update of Investment Policy to incorporate new regulations and investment powers and authorize the diversification of the portfolio both in terms of credit and term exposure.
- Update of Capital Financing and Debt Policy to incorporate new regulations and reporting requirements related to debt instruments and specifically for financing leases.
- Implementation of a more dynamic and balanced investment strategy which realized significantly enhanced portfolio returns; more diversification; and improved overall credit quality of security holdings. As previously reported to Council in Treasury's 2004 Annual Investment Report, implementation of the new investment strategy resulted in additional returns of $9.1 million ($4.3 million in 2003) compared to the ONE Fund. The actual rate of return for the Region's portfolio was 3.27% in 2004 which was 1.05% higher than the ONE Fund's return of 2.22%. Table 1 below provides a summary of the relative performance of the Region's investment program for the past 5 year period.

Table 1 - Comparison of Portfolio Returns

		ONE Fund		Private Sector	
Year	**General Fund**	**Returns**	**Difference**	**Returns**	**Difference**
2004	3.27%	2.22%	1.05%	1.39%	1.88%
2003	3.34%	2.82%	0.52%	2.22%	1.12%
2002	2.76%	2.39%	0.37%	1.55%	1.21%
2001	4.58%	4.27%	0.31%	3.59%	0.99%
2000	5.63%	5.45%	0.18%	N/A	N/A

- Co-ordination of the investment and borrowing programs to both enhance portfolio returns and provide significant savings relating to debt issuance costs.

- Taking inter-municipal leadership role to effect successful negotiation of Fiscal Agency fees for benefit of all Canadian municipalities.

Treasury wishes to thank all those involved in the review of its procedures and practices and for their valued input and recommendations.

Below is a list of opportunities noted during the course of our audit requiring management's attention.

There is a lack of segregation between deal initiation, confirmation and reconciliation which are all currently performed by the same front office trader. Duties and functions should be clearly delineated and defined between front and back office roles. These functions along with their controls should be well documented in policies and procedures which should also help to minimize business interruptions should key resources depart from the Region.

From a completeness perspective, we noted there is no process to ensure all trades executed by the trading desk are reconciled to the general ledger and to the custodian records on a timely basis. This shortcoming is further complicated by the fact that there is a duplication of investment systems which are not reconciled to one another.

We have made a number of recommendations to enhance risk and financial reports for management. In addition, we have identified a number of updates to the existing Treasury policies that should be considered, as well as recommendations of performance benchmarking measurements.

There may be opportunities for greater efficiencies through streamlining the current duplication of efforts resulting from maintaining two investment systems. To address the segregation of duty issue, staff that does not have trading authority should be performing functions that are traditionally done by the back office. These would include confirming trades and performing reconciliations of trading activity.

Lastly, we have included an 'Enhancement Opportunities' section which highlights improvements that management can consider implementing to increase the overall transparency and controls in the Treasury department.

A draft copy of this report has been discussed with York Region Treasury management. They have provided us with their comments and have agreed to take the necessary action to implement the noted recommendations.

Should the reader have any questions or require a more detailed understanding of the risk assessment and sampling decisions made during this audit, please contact the Director, Audit Services.

We wish to thank York Region's Treasury and Financial Services management and employee staff for their co-operation and assistance in providing Audit Services with requested documentation and timely responses.

2.0 Introduction

The primary objectives of the Finance Department's Treasury Function at Region of York are to efficiently manage and preserve the financial assets of the Region, limit financial risk exposure, and maintain liquidity and long term financial flexibility, while earning a competitive rate of return and adhering to current statutory requirements. These objectives are reflected in the policies governing the Treasury Function, which limit the Region to a relatively risk averse strategy. The Treasury Function is a sub-group within the Policy, Risk and Treasury Branch of the Finance Department. The Commissioner of Finance and Regional Treasurer is ultimately responsible for the Region's Treasury operations.

The scope of our Treasury review included the following investment and debt issuance activities:

- Daily cash forecasting, banking and investment of excess funds from operations and longer term investments of sinking funds;
- Short-term funding of day-to-day operations;
- Capital financing for current and future requirements in consultation with operating departments;
- Accessing financial markets for the most cost effective source of funding;
- Arranging and administering debt issues for the Region of York and its local municipalities and School Boards; and
- Conducting financial analysis and research.
- Reviewing leases and reserves

<u>Cash Management</u>

The Region must comply with the regulations set out in The Municipal Act, as issued by the Ontario Government. As well, the "Regional Municipality of York Investment Policy", sets out the framework in which the Treasury Function operates. The latest version of this investment policy is dated June 2002 and was approved by Council at that time.

As of April 2005, total investments held by the Region were C$875 million which consisted of C$453 million in Government Bonds and money market securities (Federal, Provincial and Municipal), C$371 million in bonds and money market securities with Canadian Schedule I Banks, C$15 million in commercial paper, C$25 million in asset-backed securities and C$11 million held with ONE fund (public sector group of funds).

The Investment Policy only allows a restricted set of investments to be utilized as outlined in Appendix 1 of the Policy. The Policy allows for government securities, financial institutions' securities and deposits, asset-backed securities and short term (less than one year) commercial paper.

<u>Debt Management</u>

The main activities for debt management performed by the Treasury Function are:

- Research, initiation, preparation, tender and negotiation of new debt issues;
- Administrator of outstanding debt;

- Due diligence over the debt issuance process in conjunction with external legal counsel; and
- Liaison with Bond Rating Agencies such as Moody's Investor Service and Standard & Poor's on a regular basis.

The issuance of debt is subject to provisions of The Municipal Act and the Region's Capital Financing & Debt Policy, which was approved by Council in January 2003. Debentures are issued approximately twice a year, and require a By-law authorized by Regional Council. The Region may issue debentures on its own behalf, for local municipalities and for School Boards. The credit rating for the Region is AAA (Aaa), which provides the local municipalities and School Boards with access to cheaper funding. Debentures are issued for bundles of municipal infrastructure projects (larger, more liquid debt issues are generally rewarded with lower yields in financial markets), usually through a syndicate of investment dealers.

Once issued, debentures are administered by the Treasury Function. This includes tracking and processing interest and principal payments to certificate holders, the issuance of T5s and the re-registration of debentures, as required.

The Capital Financing & Debt Policy allows for the issuance of foreign currency debt but considers Canadian dollar denominated debt the general practice. The Policy also considers fixed rate debentures to be the standard form of long-term financing but allows for variable rate debentures if a decline in interest rates is likely. The Policy allows for interest rate exchange agreements to be used as hedging tools for variable interest bank loan agreements. Treasury currently does not hold any variable rate debentures and to date has not yet entered into an interest rate exchange agreement.

3.0 Objectives and Scope

The objectives of this engagement are to ensure:

- York's compliance with the Municipal Act, York Region's Capital Financing & Debt Policy, and York Region's Investment Policy.
- The existence and appropriateness of the governance process.
- That financial and management reporting are timely and accurate.
- The existence and operational effectiveness of key control procedures relating to all aspects of Treasury transactions (initiation, processing, recording and reporting).
- Benchmarking tools for the investment portfolio are appropriate.
- Treasury software is effectively utilized.

The audit objectives were accomplished through:

- Meetings with management and Treasury staff to discuss trading strategies and to review policies and procedures surrounding the Treasury Function;
- A review of the management reporting and risk analysis;
- A review of authorized products and their limits to ensure consistency with investment objectives and compliance with statutory requirements;

- Sample testing of investment transactions to ensure that trades were executed and captured in a timely and accurate manner, both in the front office system as well as the general ledger;
- A review of Treasury's processes for debt issuance and the respective supporting documentation files as maintained by Treasury;
- A review of the methodology for and accuracy of Treasury's cash flow forecasting;
- A review of the methodology over the reporting of leases;
- A review of the change management controls for systems used to track investment activities and cash flow spreadsheets;
- A review of key reconciliations over daily cash movements and securities;
- A review of journal entries supporting month end financial reporting.

4.0 Detailed Observations and Recommendations

4.1 Segregation of Duties

Observation

An individual who executes daily trades in the short term book is also performing functions typically carried out by back office personnel such as reconciliations and trade confirmations. Insufficient segregation of duties between front and back office functions can increase the possibility of errors or fraudulent activity.

Recommendation

Duties performed by the trading desk and those typically performed by the back office should be clearly segregated to maintain the integrity of the financial records and to enhance the control environment to reduce the possibility of error or fraudulent activity. Back office functions (e.g. online confirmation of trades with the custodian), should be reassigned to individuals who do not have trading authority. If an individual in Accounting is selected to perform this task, they should not be involved in inputting journal entries related to Treasury activities.

Treasury Management Response

The Region currently contracts "custodial" services from the Royal Bank of Canada. As part of this service they provide a system in which both the seller and the purchaser of a security must agree on the details of a trade before it can settle, thereby independently confirming the accuracy of the trade details. In addition, to reduce the risk of fraud, all trades can only be made in the name of the Region and trade funds can only go to and from the Region's bank accounts. In addition to the controls already in place, Treasury staff not directly involved with the trade will now be responsible for on-line confirmations and an additional custodial statement will be sent directly to Accounting for further verification.

4.2 Key Man Risk

Observation

Although Treasury has some procedural documentation in place (e.g. cash management and investment procedures), we noted that they did not contain the level of detail to continue operations should people leave the organization, nor did they cover processes such as trade execution, transaction processing, trade confirmations and corrections. Without detailed procedures over all aspects of the Treasury process, the Region can be exposed to unforeseen financial losses and operational risks.

Recommendation

All processes for the front and back office functions in the Treasury group should be clearly documented, outlining and separating the roles and responsibilities required for each area. This policy and procedures manual should be kept up to date and be accessible by all staff members.

Treasury Management Response

Treasury currently maintains a Cash Management and Investment Procedure manual which describes the daily trading functions of the investment program.There are also a number of controls already in place to mitigate "key man" risk such as Treasury's practice to fully cross-train the Senior Investment Analyst, Senior Financial Analyst and the Finance and Reserve Specialist positions to perform all trading and reporting functions. In addition, the Manager of Treasury and Reserves and the Director of Policy Risk & Treasury are able to perform trades on an as needed basis.

To further enhance its practices, Treasury Management will by year-end (Q4 2005) review all written procedures to ensure any revised procedures or processes for front and back office functions implemented as a result of this report are appropriately reflected therein.

4.3 Duplication of Investment Systems

Observation

Treasury and Accounting each maintain similar databases of investment activities that are used to perform their respective daily and periodic responsibilities. There is a duplication of effort in maintaining both the database and spreadsheet, and there is no reconciliation between the two systems to ensure that they are consistent.

Treasury employs MS Access to track and report on investment positions and to monitor limits. Accounting utilizes MS Excel to track investment activities and is used to post their journal entries at month end.

Recommendation

To help reduce inefficiencies created when maintaining similar files, Treasury and Accounting should investigate the feasibility of eliminating the use of one of the files. If eliminating one of the files is not possible, then a periodic reconciliation of the two databases needs to be established to help ensure that the information in both applications is and remains accurate and complete.

Given that the size of the investment portfolio and trading activity continues to increase, Treasury management should consider exploring the use of a more robust investment system with general controls to help ensure the integrity of the information for portfolio management, allows for the proper segregation of duties between front and back office; can be configured for the automatic generation of management reporting; and can be interfaced with the general ledger for accounting and reporting purposes.

Treasury Management Response

Treasury uses two internally developed reporting systems. A Debt Management System which was designed for municipal sector needs to track debentures, allocate debt expense, create T5's and re-register debentures. Also an Access based system is used to track and report the details of its investments.

Prior to incurring the significant expense needed to purchase and maintain a more robust "off the shelf" system, a determination of the incremental benefits of such a system would have to be made.

In the interim, Treasury Management proposes to undertake by year-end (Q4 2005) a review of possible enhancements to the existing investment system to determine if it can be enhanced to meet Accounting's needs for reconciliations and reporting.

Accounting Management Response

Accounting Management agrees with this recommendation.

While Treasury Management is investigating the need for a more robust system, Accounting will investigate if it is possible to eliminate either the access database or the excel spreadsheet. We will have a decision by year end – Q4 2005.

In the meantime, Accounting is reconciling these two files quarterly.

4.4 Key Reconciliations

Observation

Reconciliation of the MS Excel spreadsheet containing daily trade activity to the on-line custodial activity statement to ensure that all trades have been captured accurately is not presently performed.

Reconciliation of expected interest coupons from investment positions to actual interest coupons received is not currently performed.

Recommendation

Accounting management should ensure that:

1. The MS Excel spreadsheet used to track daily trade activity is periodically reconciled (daily or weekly) to the on-line custodial activity statement. This would help to ensure accuracy and completeness of accounting records.
2. On a monthly basis, a detailed reconciliation between the excel spreadsheet and the general ledger should be performed to help ensure that all realized cash flows are in balance.

3. A process should be implemented to ensure that expected interest coupons from investment positions have been received on a timely basis.

All reconciliations should be retained to evidence proper control performance and review.

Accounting Management Response

Accounting Management agrees with this recommendation and is:

A) reconciling our excel spreadsheet to the on-line custodial statement weekly
B) reconciling our excel spreadsheet to the General Ledger monthly
C) ensuring all expected interest coupons are received on a timely basis

4.5 Document Cash flow Methodology and Assumptions

Observation

Treasury management has not documented their cash flow methodology and the assumptions used for short term cash management and longer term cash flow projections.

Recommendation

Refinement of the cash flow methodology and assumptions would minimize the incurrence of unnecessary costs that may arise due to liquidation of investment holdings and would facilitate the implementation of long term investment strategies. Documentation of cash flow methodology could include Treasury's end of day target range for cash balances; the cash management strategy of staggering investment maturities to ensure sufficient liquidity is maintained; and the roles of accounts receivable/payable in providing advance input on expected and material cash flows. Treasury management should continue its practice of reviewing overdraft interest charges incurred as a way of gauging the accuracy of the cash management forecasting model.

Treasury Management Response

It is Treasury Management's practice to ensure there are adequate short-term investments to provide sufficient liquidity to cover all Regional expenditures as they occur throughout the year. To-date there have been no occurrences of unnecessary costs incurred due to the need to liquidate any short or long-term holdings. In order to ensure appropriate levels of liquidity Treasury currently performs the following:

1. Prepares annual forecasts of both working capital and long-term capital requirements.
2. Prepares daily, weekly and monthly cash-flow forecasts of all anticipated expenditures.
3. Maintains an investment strategy that takes into due consideration both capital preservation and liquidity needs.

Treasury Management recognizes the importance of reviewing and updating procedures and documentation relating to the cash-flow forecasting process. Such a review will be completed by the fourth quarter of 2005. In addition, Treasury will continue as is its current practice to review overdraft interest charges incurred as a way of gauging the accuracy of the cash forecasting model.

4.6 Increase Frequency of Marking to Market (MTM) the Investment Portfolio

Observation

In recent years, there has been an increase in market risk exposure as the size and diversity of the investment portfolio has grown and the weighted maturity has moved from 60 days in 2001 to about 600 days in 2005. The Investment policy states that the market value of the portfolio shall be calculated at least annually which in today's rapidly changing financial environment is not frequent enough to effectively risk manage a portfolio.

Recommendation

We recommend that the frequency of the MTM be increased in order for management to be aware of the risks in the portfolio on a timelier basis. In the event that the custodian statements has indicated a market price that is not reflective of the market. Treasury management should explore different valuation sources (e.g. broker quotes). To maintain the integrity of the MTM process, the back office should independently verify the prices used in the valuations. This price verification needs to be retained as evidence for proper control performance and review.

Treasury Management Response

The portfolio is currently marked-to-market on a monthly basis by the Region's custodial agents, the Royal Bank of Canada (RBC). RBC is an independent and cost effective source of pricing. To engage more frequent pricing and/or different service providers would result in significantly increased costs and require considerably more staff time with little or no reporting enhancements.

Treasury Management does not see the merit in incurring the costs of secondary valuation sources as the Region's investments are all in compliance with Provincial regulations; include only conservative, investment grade, highly marketable and liquid securities; and, as overall liquidity positions are more than sufficient. Furthermore, most municipalities with significant bond positions use only one service provider. Annual costs for an additional provider could range from $20,000 to $40,000 and would require additional staff time to input information and would provide only marginal reporting enhancements.

It has been Treasury Management's intent to increase the frequency of mark-to market portfolio performance reporting as soon as the composition of the Region's portfolio changed from a short-term liquidity-based portfolio to a more balanced fixed income portfolio whose average term was greater than 2-years. To date however given the conservative nature and low price volatility of the investments held any duration or credit risk has been relatively minimal. Additionally, short-term money market holdings provide adequate liquidity to meet the Region's cash-flow needs.

For management reporting purposes, as recommended above and as was Treasury Management's intent, monthly mark-to market performance valuation based on RBC pricing will be instituted starting January 2006.

4.7 Enhance existing Investment Reports to Senior Management and Council

Observation

Management reporting over investment activities is currently limited to monthly reports to Treasury and the Director of Accounting, and annual reporting to Finance & Accounting and Administration Committee and Council. In order to facilitate oversight of investment activities, Treasury management should enhance the content and frequency of their existing reporting process.

Recommendation

We recommend the following enhancements to the reporting over investment activities to management:

- E*xception reports* – daily reports should be provided to the traders and to management to ensure compliance with stipulated limits and authorized products. A report highlighting trade cancel and corrects should also be provided to management.
- *Unrealized P&L* – include unrealized gains / losses in addition to the realized that is currently reported monthly to provide value added portfolio management and performance of existing positions.
- *Broker utilization* – periodic reporting to provide management with concentration of value and dollar amounts with brokers in both Money Market and Bond Funds to monitor against potentially improper trader dealings with brokers.
- *Interest rate sensitivity analysis (e*.g. PV01) *and Stress Testing* –monthly to highlight to management the dollar value impact of changes in interest rates.

Treasury Management Response

Exception Reports – Agreed. These reports which are currently available on a “when requested” basis are now automatically issued on a daily basis.

Unrealized P&L – Agreed. These reports will be instituted at the same time as the mark-to-market performance valuation described in 4-7 above in January 2006.

Broker Utilization – Agreed. This report has been prepared in the past but has fallen out of use. Quarterly summaries of broker activity for both Money Market and Bonds are now being tabulated and reported quarterly.

Interest Rate sensitivity analysis and stress testing “Price Value of a Basis Point” and “Value at Risk” analysis – Agreed. These reports have now been incorporated in monthly management reports.

4.8 Enhance Portfolio Performance Measurements to Management and Council

Observation

Front office and Accounting are utilizing different measurement methodologies when reporting investment performance and neither system takes into account the portfolio's unrealized gains and losses.

The 2004 annual Investment Report compared the investment performance of Treasury with the 'ONE Fund' and with private sector money market mutual funds. We noted that the use of these money market indices for comparison may not be appropriate as York's portfolio is managed to assume more interest rate risk as evidenced by the authorized tenure limits outlined in the Investment Policy. Also, the ONE Fund is a managed fund and thus may be an inappropriate comparison against York's performance as it is not an investable benchmark.

Recommendation

We recommend that the investment performance measurement methodology be documented and validated to ensure accurate reporting. The reporting of investment performance to Council should be based on general ledger figures from Accounting and should include realized cash flows (i.e. realized gains/losses, coupons, amortization of premiums/discounts) and unrealized capital gains/losses which would be captured from marking to market the portfolio should be disclosed in the financial statements.

We also recommend the use of an appropriate performance benchmark that is more aligned with York's investment objectives and risk appetite. For performance measurement purposes, York Region's investment portfolio can be segmented into two portfolios (i.e. less than or greater than one year term-to-maturity) with performance benchmarked against appropriate investable benchmarks (e.g. Scotia Capital Short Term All Government Total Return index and money market indices).

Treasury Management Response

Treasury Management considers the LAS "ONE Fund" to be a good primary benchmark for comparing the performance of the Region's overall portfolio as it reflects the municipalities' next best alternative to in-house investment management. The risk profile and investment returns of the ONE Fund are comparable to what would be expected for a short-term municipal portfolio whose principle objectives (similar to those highlighted in the Region's Investment Policy) are capital preservation and liquidity. This is a logical default benchmark as it is one of the lowest cost managed investment funds, with consistently top quartile performance and whose holdings most closely match those eligible securities as authorized by Provincial regulation and the Region's Investment Policy.

In addition to the "ONE Fund" Treasury also compares annual portfolio returns to privately-managed money market mutual funds. The Region's portfolio returns have consistently outperformed these funds by a significant margin as well despite the fact that these funds are managed on a full-time basis by money market professionals and have less restrictive mandates and lists of eligible investments.

Treasury Management agrees that as the average term of the portfolio exceeds two years that longer term benchmarks such as the indices recommended above should be considered as useful management performance comparators. Implementation of these new standards are anticipated to commence by the end of the first quarter of 2006.

4.9 Update Investment and Capital Financing & Debt Policies.

Observation

In order to strengthen internal controls over the Treasury functions, the Investment and Capital Financing & Debt Policies should be enhanced to include more detail and to clarify roles and responsibilities.

Recommendation

The current Investment and Capital Financing & Debt Policies should be updated to address the following:

- Delegation of responsibilities and functions of Treasury staff delineated between front office, back office and a potential risk management committee.
- Treasurer/Director's ability to delegate day-to-day investment management to the Treasury Manager.
- The appropriateness of the limits assigned to Municipals (35%) and Asset-Backed debt (20%) in Appendix 1 of the Investment Policy, which in aggregate could total to 55% of the total portfolio.
- Responsibility for and the frequency of limit monitoring, exception reporting and remediation requirements when limits have been breached.
- Responsibility for monitoring credit rating changes on investments and how these changes can be communicated on a timely basis to Treasury and Accounting staff.
- As stipulated in O. Reg. 266/02, s9 (1), the Capital Financing and Debt Policy should require that corporate departments advise the Region in writing of a proposed financing lease before entering into the agreement in order for the Treasurer to assess the costs and risks associated with the lease. This requirement must be disseminated to all corporate departments in a detailed policies and procedures manual and have an appropriate enforcement mechanism.

Treasury Management Response

- Delegation of responsibilities and function of Treasury staff -Agreed. This will be Incorporated in next update to Investment Policy anticipated by Summer 2006.
- Treasurer/Director's ability to delegate. Agreed. This will be incorporated in the next Investment Policy update.
- Appropriateness of Limits to Municipalities and Asset-Backed Securities. Most of the Region's holdings of municipal securities are rated "AA" or higher and all asset-backed securities are rated "AAA" and have a term of less than 5 years. All holdings are actively traded marketable securities that represent virtually no credit or liquidity risk.

Additionally, the portfolio maintains ample short-term holdings to meet all potential cash flow requirements. All sales related to these securities have been based on market/strategy views, not liquidity concerns. Unlike many privately managed investment programs the Region is governed by a relatively restrictive and conservative list of eligible investments as regulated by the Municipal Act. By default, therefore, it is necessary to hold larger positions in certain asset classes (such as municipal and asset-backed securities) than would a typical privately-managed investment portfolio. Furthermore, due to the nature of the Region's municipal focus, Treasury finds it advantageous both as an investor and issuer to support its own debt as well as other municipalities especially within Ontario. Therefore, Treasury Management does not consider the existing limits for these securities inappropriate.

- Responsibility for and the frequency of limit monitoring -Agreed. This will be incorporated in the update to Investment Policy anticipated by Summer 2006.
- Responsibility for monitoring credit rating changes to be incorporated in update to Investment Policy - Agreed. This will be incorporated into next Policy update.
- As stipulated in O.Reg. 266/02, 5.9 (1) – The Region has an approved Capital Financing and Debt Policy that stipulates reporting requirements and Treasure's responsibilities related to financing leases. Treasury Management agrees to establish more formal procedures to be disseminated to all responsible departments by Spring 2006.

4.10 References to the Municipal Act

Observation

O. Reg. 276/02 s. 8 (2) defines when a municipality cannot enter into a variable interest rate bank loan agreement, but the Capital Financing & Debt Policy needs to clarify with respect to when hedging will not be allowed as it pertains to a variable interest rate bank loan agreement. Also, the Capital Financing & Debt Policy should be more consistent in setting out the conditions for entering into variable interest rate bank loan agreements, and makes no reference that all of the municipality's long-term debt obligations must be rated on the date the municipality enters into a variable interest rate bank loan agreement O. Reg. 276/02 s. 9.

O. Reg. 276/02 s. 10 & 11 makes reference to specific criteria for entering into interest rate exchange agreements as a hedging tool for variable interest rate bank loan agreements, but the Capital Financing & Debt Policy does not detail these same criteria but instead simply refers to a 'hedging strategy'.

Recommendation

The 2003 Capital Financing & Debt Policy should be updated to reflect in greater detail the O. Reg. 276/02 s. 8 (2), 9, 10 & 11 with respect to entering into a variable interest rate bank loan and interest rate exchange agreements.

Treasury Management Response

Agreed. This will be incorporated in update to Capital Financing and Debt Policy anticipated by Summer 2006.

4.11 Enhance Debt Issuance Process

Observation

The debt issuance process is intensive and requires the timely compilation, review and approval of a comprehensive set of documentation (e.g. approved business plans and budget, management attestations/certifications, etc.) from amongst many internal (e.g. Budgeting, Treasurer, and Council) and external (e.g. area municipalities, external legal counsel, underwriters, and Canadian Depository Service) groups. Treasury management is involved in structuring the terms of the debt and providing oversight of the documentation compiled by the senior financial analyst in Treasury.

To ensure that all the necessary activities have been executed with sufficient management oversight, there is a need to implement procedural documentation that clearly outlines all required activities (e.g. structuring debt, information compilation, calculation of debt servicing ratios, review of syndicate negotiated rates with market rates) and roles and responsibilities (e.g. initiating, review, and approvals).

Recommendation

Given the similarity in the required activities for each debt issuance, the development of a procedures manual and checklist would allow management to ensure that all the required activities have been completed, and facilitate management's review and approval responsibilities.

Treasury Management Response

Treasury currently has procedures and a check list in place and but agrees to the need to formalize and update them on a regular basis to incorporate procedural or regulatory changes. The next update will be completed by the end of 2005..

4.12 End User Access and Business Continuity Plans

Observation

The access database and accounting spreadsheets for investment activities are currently not saved daily to the server and could be accessed by unauthorized users.

There is no business continuity plan specific to Treasury in case of an unexpected disruption.

Recommendation

To prevent unauthorized user access, the access database and accounting spreadsheet should be password protected with a requirement that passwords be changed periodically. The access database and accounting spreadsheet should be saved daily to the server and restricted access to them must be granted based on staff's respective functions.

There is a need to develop a business continuity plan for the Treasury department that considers back-up location, personnel, systems, access to files and records, telephones lines, etc. The readiness of this facility should be periodically tested to ensure that portfolio management activities would not be disrupted for an extended period in the event of a business interruption.

Treasury Management Response

The access data base is maintained by the Senior Financial Analyst and accessible only by staff of Policy, Risk & Treasury. To increase security, steps have already been taken to restrict access to only a limited number of authorized PR&T staff involved in the investment function, and the addition of password protection that will require periodic changing.

In the past the access database has been saved to the server at least on a weekly basis as a hard copy of investment positions is downloaded daily. To augment this procedure, this data is now being uploaded to the server on a daily basis as recommended.

The Region has a disaster recovery plan in place including procedures relating to debt and investments. Treasury is preparing its own Business Continuity Plan in conjunction with a review being undertaken by the Emergency Measures Branch. The recommendations proposed above will be considered for implementation subject to review undertaken by the Emergency Measures Branch.

5.0 Enhancement Opportunities

5.1 Oversight Committee

Recommendation

We note that risks of the investment portfolio are currently well managed through good management oversight and restrictive investment limits. However, as the risk profiles in the investment portfolio change, we would recommend the formulation of an oversight committee. The oversight committee would be responsible for monitoring investments and investment results, ensuring prudent investment of funds, and recommending changes to the Investment Policy. The committee should be comprised of senior members of Treasury as well as other senior members of the Region's administration.

Treasury Management Response

Agreed. As the risk profile of the investment portfolio change significantly in the future, the formation of an oversight committee and its appropriate composition will be considered.

5.2 Evidence of Management Review

Recommendation

As the volume of investment transactions increases, it will become necessary for the front office to maintain a trading blotter to be reviewed and signed-off by the Manager in Treasury on a daily basis. The daily trading blotter will need to be retained to evidence proper control performance and review. A copy of the trading blotter should be provided to Accounting in addition to the individual tickets to ensure the completeness of transactions reported.

A trading blotter is an additional control for many large treasury or trading operations, such as banks and fund managers. Currently, Treasury management feels that based on the Region's relatively low volume of transactions and number of staff involved in the investment program, keeping a daily investment blotter would involve additional staff time and effort for marginal benefit.

Treasury Management Response

To ensure that all trades are properly monitored, Treasury's current practice is to have all transactions sequentially numbered and trade tickets reviewed and signed off daily by the Manager. In addition, all investment transactions are recorded by the Royal Bank of Canada as part of its "custodial" function and confirmations are sent to the Region to be matched to trading tickets. Furthermore, all long-term transactions are undertaken, recommended, revised and/or confirmed by the Manager at time of execution.

Should the number of investment transactions increase significantly beyond its current volume, Treasury management will consider the benefits of implementing a trading blotter.

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