



POLICY NUMBER: [Use Records Retention By-Law for Numbers]

DEPARTMENT: Finance **CONTACT:** Director of Finance

SUBJECT: Reserves & Reserve Fund Policy

APPROVAL DATE: [Enter Date]

REVISION DATE: [Enter Date]

APPROVED BY: [Sarnia City Council]

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PURPOSE

The primary purpose of the Reserves and Reserve Funds Policy is to ensure the ongoing financial stability of the City by setting aside monies for the long term goals of the municipality and ensuring that those funds will be available when needed.

The policy is intended to establish consistent standards, which will assist in the development, maintenance, and use of Reserves and Reserve Funds in a responsible and consistent manner.

POLICY STATEMENT

It is the policy of the City of Sarnia to:

- Maintain Reserves and Reserve Funds for:
 - planned future capital rehabilitation/replacement
 - unexpected/unpredicted expenditures which would otherwise cause fluctuations in the operating or capital budgets
 - irregular or occasional expenses
 - segregation of funds for a specific purpose or agreement
 - obligations payable in the future
- Manage Reserves, Reserve Funds in a responsible manner
- Prohibit the spending of any Reserve or Reserve Fund below zero
- Use Reserves, Reserve Funds solely for the intended purpose

SCOPE/APPLICATION

Section 417 of the *Municipal Act, 2001* allows a municipality to provide for the establishment and maintenance of reserve funds for the purpose for which it has authority to spend money.

This policy applies to all departments and local boards, including Police Services, of the Corporation of the City of Sarnia. This policy shall be applied fairly and consistently in a manner that maintains the purpose, intent, and meaning of the policy.



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GLOSSARY OF TERMS

Reserve Fund – A reserve fund requires the physical segregation of assets and is restricted to meet the purpose of the reserve fund. There are two types of reserve funds: Discretionary and Obligatory.

Discretionary Reserve Fund – A reserve fund established at the discretion of Council whenever revenues are earmarked to finance future expenditures. All earnings derived from such investments must form part of the reserve fund.

Obligatory Reserve Fund - A reserve fund created by legislation which stipulates that revenues received for special purposes be segregated from the general revenues of the municipality. All earnings derived from such investments must form part of the reserve fund.

Reserve – An allocation of accumulated net revenue that does not require the physical segregation of money or assets. Reserves do not earn interest on their own. Any earnings derived from investment of reserves' money are reported as general fund earnings.

Deferred Revenue – Revenue that is considered a liability on the municipality's financial statements, until such time it becomes relevant to current operations. It is set aside as an obligatory reserve fund for a specific purpose required by legislation, regulation, or agreement.

City – The Corporation of the City of Sarnia.

Contribution- funds added to a Reserve or Reserve Fund account, for example revenues directly to reserves as included in the annual budget documents or an expense included in the operating budget.



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Commitment – approval by Council to spend funds up to a specified amount on projects or task, such as capital projects, one-time expenditures, or direct from reserve expenditures.

Expenditure – disbursement of funds associated with a commitment.

Non-recurring Revenue – revenue that is unlikely to occur again in the normal course of business

Employee Future Benefits – Benefits earned by active employees that are expected to be provided to them when they are no longer providing active service, such as post-retirement medical insurance benefits.

PROCESS

The City categorizes Reserves and Reserve Funds into the following:

- Stabilization, such as Operating Contingency, Tax Stabilization
- Program Specific, such as WSIB, Self-Insurance, Energy Management
- Vehicle and Equipment Replacement
- Building Rehabilitation/Replacement
- Infrastructure Rehabilitation/Replacement
- Legislative, such as Development Charges, Building Permits
- Contractual, such as Gas Tax

In the administration of Reserves and Reserve Funds, the following principles will be followed:

1. Creation

Council, on recommendation of the Director of Finance, will approve the establishment of new Reserves or Reserve Funds. The following will be established:

- purpose and use
- type
 - interest bearing – generally for future liabilities future development properties, emergency capital or legislated



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- non-interest bearing –infrastructure/equipment/building replacement, operational, and stabilization/contingency reserves
- funding sources and target funding level (if applicable)
- projected annual revenue and spending for at least 10 years

2. Consolidation/Close

If the purpose of a Reserve or Reserve Fund has been accomplished or is no longer necessary, Council, on the recommendation of the Director of Finance, will approve the closure or consolidation, and transfer of any remaining funds.

3. Contributions, Commitments and Expenditures

Council, as a part of the annual budget approval process, approves the contributions and commitments from Reserves and Reserve Funds. If not approved through the budget, a resolution of Council is required, except for contributions such as interest, development charges, or net recoveries of prior year events.

Expenditures are managed by staff within the Council-approved commitments.

- At times, change orders may be required due to uncontrollable factors; the authority to utilize Reserve or Reserve Funds beyond the council-approved commitment will be directed by the *Procurement of Goods and Services Policy*.
- At times, implementation does not occur as originally planned due to unexpected conditions. Solutions may vary without additional approval if they are aligned with the purpose for which the commitment was approved. Otherwise repurposing of committed funds requires the approval of Council.

Reserves or Reserve Funds cannot have a balance below zero. If this occurs the expenditure will be allocated through the applicable



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operating budget or contingency reserve with a report to Council identifying the implications.

4. Lifting of Commitments

Commitments that are not fully spent at the end of the fiscal year following the budget year of approval will be lifted (removed). If the project is not complete by the end of the second year, a request will need to be brought back to Council for re-confirmation of the commitment; generally, during the annual budget process.

5. Interest Allocation

Interest on Reserve Fund balances will be calculated and added on a monthly basis based on the interest obtained from the general operating bank account or a contractual agreement.

6. Lending/Transferring for Other Purposes

Inter-reserve lending to cover a Reserve or Reserve Fund shortfall is permitted and encouraged to avoid external borrowing costs. Lending may only occur when an analysis of the Reserve or Reserve Fund has determined that the amount will not adversely affect the intended purpose of the Reserve or Reserve Fund. Council will approve the amount and term, and staff will apply a reasonable market rate of interest to the Reserve Fund that has provided the borrowed funds.

Applicable legislation must be followed with respect to inter-fund lending, such as the *Development Charges Act*.

Only after viable alternatives are exhausted staff may recommend repurposing of commitments. Council may, by by-law, authorize the repurposing of a Reserve or Reserve Fund be commitment to a purpose other than for which it was originally established, subject to applicable legislation.



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7. Reporting

Finance staff will prepare the following reports, as a minimum, in relation to Reserves and Reserve Funds:

- Annual Audited Financial Statements and Financial Information Return (FIR) – for financial reporting purposes, reserve funds set aside by legislation, regulation, or agreement (obligatory), are reported as deferred revenue, a liability on the Consolidated Statement of Financial Position. Other reserve funds (discretionary) and reserves, are balances within the accumulated surplus.
- Annual Budget Process – includes review of current forecast of revenue and expenditures and adequacy to meet future needs.
- Other legislated reporting – as required, such as Development Charges statement.

8. Adequacy and Targets

Reserve and Reserve Fund levels will be monitored and reported on a regular basis, generally within the annual budget process. When inadequate balances occur, staff will make recommendations to Council regarding strategies to work toward the target.

Adequacy will be assessed by reviewing actual balances versus specific targets, and reviewing various ratios.

Comparing funds held in Reserves and Reserve Funds to a single year's own-source revenue is a common ratio; a value over 50% for each of the following is an indicator of strong financial stability:

- Tax Discretionary Reserves divided by Property Tax Revenue
- Water Reserves divided by Water Own Source Revenue
- Wastewater Reserves divided by Wastewater Own Source Revenue



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The ratio of Debt to Reserves is another common ratio which is an indicator of financial prudence. The ratio should be less than 1, which means that debt (excluding development charge funded debt) outstanding should not exceed reserve (excluding obligatory) balances.

The City will work toward the following general targets:

- Tax-supported Stabilization 5-10% of gross expenditures
- Rate-supported Stabilization 5-10% of gross expenditures
- Asset rehabilitation and replacement requirements will be aligned with the Asset Management Plan (AMP); however, a general target approximation based on replacement cost is:
 - Facilities/Buildings 2-3%
 - Roads/Bridges 2-3%
 - Water/Sewer 1-2%
 - Vehicles/Equipment 10%
 - Employee Future Benefits 2 times the estimated annual benefit payments from the most recent audited financial statements

As warranted, targets will be calculated for individual Reserve or Reserve Funds on a case-by-case basis, and the Director of Finance will make recommendations to Council. Consideration will be given to the following:

- purpose of the Reserve or Reserve Fund
- predictability of revenues and volatility of expenditures
- certainty of future liability
- economic factors (inflation, interest rates, cyclical pressures)
- industry/government/accounting standards and best-practices

9. Operating Surplus/Deficit and Non-Recurring Revenues



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Reserves and Reserve Funds shall receive priority consideration for the distribution of surplus funds and non-recurring revenues. Unless extraordinary conditions exist or specified targets are exceeded, any annual operating surplus/deficit from an audited year-end will be transferred to/from:

Year End Operating Surplus/(Deficit)	Transferred To/From
General Operating (excluding Police Services)	Operating Contingency Reserve
Police Services	Police Services Operating Contingency Reserve
Transit (after maximum Provincial Gas Tax usage)	Transit Tax Stabilization Reserve
Water	Water Rates Stabilization Reserve
Sewer	Sewer Rates Stabilization Reserve

If the transfer would result in a negative balance, an alternative will be recommended to Council, with the use of capital reserves for operational funding being least desirable.

ROLES AND RESPONSIBILITIES

Council's authority and responsibility shall be to:

- evaluate and approve the policy
- direct the transfer of funds to and from Reserves and Reserve Funds through the budget process
- direct the transfer of funds to and from Reserves and Reserve Funds through Council Resolution or By-Law outside of the budget process
- direct repurposing of commitments and the lending or borrowing to and from Reserves and Reserve Funds through Council Resolution or By-Law
- direct the creation of new Reserves and Reserve Funds
- direct the closure or amalgamation of existing Reserves and Reserve Funds that are no longer required



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Finance Staff's authority and responsibility shall be to:

- provide recommendations for the establishment, closure, or consolidation of Reserves and Reserve Funds
- provide analysis and recommendations on the adequacy levels of Reserves and Reserve Funds
- provide recommendations on the repurposing of commitments and transfer of funds to and from Reserve and Reserve Funds
- provide recommendations on the borrowing/lending to and from Reserve and Reserve Funds
- manage Reserves and Reserve Funds in accordance with legislation, municipal financing strategies, and approved commitments
- prudently invest Reserve and Reserve Funds per the Investment Policy, and allocate interest appropriately
- provide long range financial planning recommendations to link the capital and asset management plan with the reserve plan

Departmental Staff's authority and responsibility shall be to:

- plan for long-term asset management replacement and rehabilitation with consideration for minimizing general levy and user rate increases in conjunction with the remainder of City services
- provide cost and revenue estimates to guide long-term planning and adequacy review
- consult Finance staff regarding requests to Council to commit Reserve or Reserve Funds outside of the annual budget process
- consult with Finance staff to determine when Reserves or Reserve Funds should be created, consolidated or closed
- manage expenditures within Council-approved commitments. If change orders are required, the authority to utilize Reserve or Reserve Funds beyond the council-approved commitment, will be directed by the *Procurement of Goods and Services Policy*

Police Services' authority and responsibility shall be to:

- plan for long-term asset management and fund replacement and rehabilitation with contributions to Reserves through the Police



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Services Approved budget with consideration for minimizing general levy increases in conjunction with the remainder of City services.

- annually submit Reserve and Reserve Fund contribution and commitment estimates for City Council to review for the purposes establishing overall budget
- consult City Finance staff regarding Police Services Board approved requests to City Council to commit Reserve or Reserve Funds outside of the annual budget process
- request the temporary borrowing of Reserve or Reserve Funds if requirements cannot be managed within available sources
- manage expenditures within Council-approved commitments. If change orders are required, the authority to utilize Reserve or Reserve Funds beyond the council-approved commitment, will be directed by the *Procurement of Goods and Services Policy*
- consult with City Finance staff to determine when Reserves or Reserve Funds should be created, consolidated or closed

REVIEW AND EVALUATION

This policy will be implemented and administered by the Director of Finance and reviewed every 4 years.