



Office of the City Auditor

1200, Scotia Place, Tower 1
10060 Jasper Avenue
Edmonton, Alberta T5J 3R8

edmonton.ca/auditor



Investment Policy Review

April 3, 2018

The Office of the City Auditor conducted this
project in accordance with the
*International Standards for the
Professional Practice of Internal Auditing*

Investment Policy Review

Table of Contents

1	Introduction.....	1
2	Background.....	1
2.1	The City’s Investment Program	1
2.2	Investment Program Policies and Governance.....	2
3	Scope.....	3
4	Objectives.....	4
5	Observations and Recommendations	4
5.1	Policy Compliance	4
5.1.1	Program compliance with Policy.....	4
5.1.2	Policy compliance with regulations.....	7
5.2	Policy Effectiveness	7
5.2.1	Policy alignment with Program objectives	8
5.2.2	Policy clear and up-to-date	8
5.2.3	Policy follows best practices	9
6	Conclusions and Recommendations	10
	Appendix 1 – Risk Assessment and Methodology for Review	13

This page is intentionally blank.

Investment Policy Review

1 Introduction

The City of Edmonton’s investment program (the Program), as identified within the *Investments White Paper*, is one of the key factors in maintaining Edmonton’s financial sustainability. The Program managed \$2.76 billion in assets as of December 31, 2017.

The Office of the City Auditor (OCA) included a review of the City’s investment policies in its approved *2017 Annual Work Plan*.

2 Background

2.1 The City’s Investment Program

The Investment Management Area manages the Program and is part of the Office of the Deputy City Manager and Chief Financial Officer in the Financial and Corporate Services Department.

The City’s investment program started in 1995 when the City sold the City-owned Edmonton Telephones to Telus Corporation for \$465 million and created the Ed Tel Endowment Fund with the proceeds.

The Program has grown since then and new funds have been added. The Program now includes seven funds. These funds include both investments the City owns as well as investments it manages for the benefit of its employees, such as the Pension Fund (for supplementary fire and police pension plans) and Long-Term Disability Fund. The City manages some of the funds directly in-house and uses multiple external managers for the remainder.

Table 1 describes the purpose of each of the City’s seven investment funds, the value of each fund at December 31, 2017, and whether it is externally or internally managed.

Table 1 – City’s Current Investment Funds as at December 31, 2017

Fund	Purpose	Value (millions)	Manager
Ed Tel Endowment Fund	To invest the proceeds from the sale of Edmonton Telephones and pay annual dividends to the City	\$864	External
Pension Fund	To meet supplemental fire and police pension benefit obligations	\$248	External
Long-Term Disability Fund	To meet long-term disability benefit obligations	\$137	External
Sinking Fund	To meet debenture redemption obligations	\$90	Internal
Money Market Fund	To ensure cash is available to cover the City’s current obligations	\$455	Internal
Short Term Bond Fund	To invest working capital in short-term investments matched to short-term obligations	\$264	Internal
Balanced Fund	To invest reserve funds in longer-term investments	\$697	External
Total		\$2,755	

2.2 Investment Program Policies and Governance

The Program is governed both by provincial regulations under the Municipal Government Act and internal City policies.

The Municipal Government Act and its regulations govern how Alberta municipalities can invest their money. The primary section of the Act pertaining to investments is Section 250 – Authorized Investments. The primary regulations that relate to the City’s investments are:

- *The Investment Regulation - Alberta Regulation 66/2000; and*
- *The Major Cities Investment Regulation - Alberta Regulation 249/2000.*

The City has also developed internal policies, procedures, and bylaws that relate to the City's investments. The primary ones are:

- *Policy C212D - Investment* (July 3, 2009) and *Procedure C212D - Investment* (September 23, 2009) – The purpose of this policy and procedure is to establish a set of investment principles and guidelines while ensuring that the City's investments comply with statutory requirements.
- *Bylaw 11713 - Ed Tel Endowment Fund Bylaw* (June 18, 2008) – The purpose of this bylaw is to establish the endowment fund and specify how withdrawals are to occur.

City Council is responsible for approving the City's investment policy, which outlines the City's investment objectives. The City Manager is responsible for ensuring compliance with the policy, while decisions of a more strategic nature are made by the Deputy City Manager and Chief Financial Officer (who also acts as the chair of the Investment Committee), with the Investment Committee operating in an advisory role and providing external expertise. The Investment Management Staff are responsible for day-to-day operations.

3 Scope

We limited the scope of this review to the City's investment policy, as well as the related bylaws and procedures that direct how the City manages investments. More specifically, this includes *Policy C212D - Investment*, *Procedure C212D - Investment*, and *Bylaw 11713 - Ed Tel Endowment Fund Bylaw*, all of which we collectively refer to as "the City's investment policies," "the Policies," or "Policy" for the purposes of this review.

The risk assessment and methodology for this review is provided in Appendix 1.

4 Objectives

Through our risk identification and assessment process, we identified the following two objectives for this review:

1. To determine if the City of Edmonton complies with its investment policies and if its policies comply with provincial regulations under the Municipal Government Act.
2. To determine if the City of Edmonton’s investment policies are effective.

5 Observations and Recommendations

5.1 Policy Compliance

The two aspects of policy compliance that we tested are:

- Program compliance with the Policies; and
- Policy compliance with provincial regulations under the Municipal Government Act.

We found that the Program complies with the Policies, with minor exceptions noted in the areas of performance measurement and annual reports. We also determined that the Policies comply with provincial regulations under the Municipal Government Act.

5.1.1 Program compliance with Policy

To determine if the Program complied with the Policies, we reviewed various areas of the Policies in detail. These included:

- Investment requirements;
- Ed Tel Endowment Fund dividends paid;
- Risk management, monitoring, and controls;
- Proxy voting;
- Performance measurement; and
- Annual reports.

Investment requirements

The Policies specify various requirements for City investments. These include limitations on the types of investments the City can make in equity investments (stock or any other security representing an ownership interest) and fixed income investments (investments that provide a return in the form of a fixed periodic payment (i.e., bonds)).

Additionally, for four out of seven funds, the Policies specify minimum and maximum ranges for each fund's asset mix – the proportion in which assets are divided among different types of investments. Based on a sample of four monthly investment reports from 2017 for all funds, the Program was fully in compliance with the investment requirements outlined in the Policies.

Ed Tel Endowment Fund dividends paid

The Policies describe how the Program should calculate annual dividends from the Ed Tel Endowment Fund. We recalculated the dividends paid in the last three years and found that they were determined using the method specified in the Policies.

Risk management, monitoring, and controls

The Policies specify various risk management, monitoring, and controls processes, such as performing an annual risk assessment or using an external custodian to hold and safeguard all City investments. We tested a sample of these processes to determine if the Program was implementing them. In all cases, the Program's processes were compliant with the Policies.

Proxy voting

As a share-owner of equity investments, the City has the right to vote on proposals presented by management and shareholders at annual general and special meetings. Since the City cannot attend these meetings it assigns someone else to vote on its behalf according to its voting instructions. This is known as a proxy vote. The City uses a proxy firm to provide recommendations and vote on its behalf.

The Policies include a description of how the Program's proxy firm should exercise, record, and report proxies. We determined that the Program's proxy firm votes proxies in accordance with the Policies.

Performance measurement

The Policies specify how the Program should measure investment performance. This includes calculating performance based on market value, reporting on a four year rolling basis, using an independent performance measurement provider, and showing Program performance compared to benchmarks. The Program measured performance as specified in the Policies, with one minor exception.

The benchmarks that the Program reported for infrastructure investments are not consistent with the Policies. Currently, as the City has only just begun to invest in infrastructure, Program staff use two benchmarks that are blended (as per industry standard) because this makes the City's performance reporting more accurate. The Policies specify the use of only one benchmark, which is the one the City will use once it has fully invested in infrastructure.

The Program is currently not in compliance with the performance measurement requirements of the Policies. However, this is due to the fact that the Policies contain requirements that currently are not relevant to the Program. The City should update the Policies to better reflect current practices. **(Recommendation 1)**

Annual reports

The Policies require that City Council receive an annual report for the Program and outlines a list of required information. We reviewed the 2016 annual report and found that all of the required information was included, with two exceptions:

- 1) The Policies require that asset mix information be included in annual reports for all funds. We found that the 2016 annual report showed the asset mixes for three

of the seven funds. These are the funds that have formal asset mix targets in the Policies.

- 2) The Policies require that annual reports confirm the Program’s policy and statutory compliance. This was not in the 2016 annual report.

Asset mix for all funds and a confirmation of policy compliance are both included in regular program reporting provided to the Investment Committee and Deputy City Manager and Chief Financial Officer. However, the Program’s annual reports should include all of the information as it is required by the Policies. (**Recommendation 2**)

5.1.2 Policy compliance with regulations

To assess if the Policies complied with provincial regulations under the Municipal Government Act, we reviewed the relevant provincial regulations that govern investments in detail. We found that the Policies satisfied the requirements found in and complied with these regulations, including the following three more significant requirements:

- 1) The Policies specify that the “Prudent Investor Rule” applies to all funds. This rule requires the City to act prudently and with care and to consider all funds as a whole when weighing trade-offs between risk and return.
- 2) City Council has approved the Policies which govern the Program.
- 3) The various investments specified in the Policies are permitted in the provincial regulations.

5.2 Policy Effectiveness

To determine if the Policies are effective, we assessed:

- If the Policies are aligned with Program objectives;
- If the Policies are clear and up-to-date; and
- If the Policies follow best practices.

We found that the Policies are effective, with opportunities to improve by making them clearer and updating them to reflect current best practices.

5.2.1 Policy alignment with Program objectives

We reviewed the processes in place for ensuring that the Policies are aligned with the Program’s objectives.

We found that there are various processes to ensure alignment. This includes:

- The involvement of the Investment Committee;
- Annual fund rebalancing – buying or selling investments to achieve a desired asset mix; and
- Arranging for an external asset/liability study every three to five years for certain funds to ensure the asset mix is appropriate to achieve fund objectives. The current Policies contain the recommended asset mixes of the most recent external asset/liability study.

5.2.2 Policy clear and up-to-date

To determine if the Policies are clear and up-to-date, we reviewed them in detail and interviewed all seven members of the City’s Investment Committee for their feedback on the Policies.

We found that the Policies are mostly clear and up-to-date with some room for improvement in the following areas:

- 1) Providing a clear description of each of the funds in the Program, their objectives, and how they are used. The amount of background information provided on the funds and each of their objectives vary widely and is scattered throughout the Policies.

- 2) Explaining how the Program manages risk around the asset allocations for all funds, not only those for which the asset/liability study is performed. For example, the Policies describe the asset/liability study as a means to ensure that the asset mix for the funds continues to be appropriate. The Policies also specify asset mix range minimums and maximums for the Balanced Fund, but do not explain how the risk around the asset mix is managed since the Balanced Fund is not included in the asset/liability study. In practice, the fund is managed to the midpoint of the asset mix ranges, which Program staff believe is a prudent approach.
- 3) Updating the Policies to reflect the current practices of the Program. We identified that the one benchmark listed in the Policies for infrastructure investments did not match the Program reporting, as discussed in Section 5.1.1.

The Policies should be revised to ensure they are clear, unambiguous, up-to-date, and understandable. **(Recommendation 1)**

5.2.3 Policy follows best practices

Overall we found that the Policies follow best practices. We confirmed this through discussions with Investment Committee members and a review of investment policies from three other municipalities with comparable regulatory environment and asset mix considerations – Calgary, Medicine Hat, and Toronto.

We interviewed all seven members of the City’s Investment Committee and four indicated they believe the policies reflect best practices and did not have any best practice suggestions or improvements to offer. The remaining three suggested requiring the Investment Committee to review the Policies periodically (which they already do, but that is not mentioned specifically in the Policies).

Our review of the investment policies of the other cities found a few practices that the City may wish to adopt. This includes specifying when or how often the Policies should be reviewed and by whom, clearly outlining the role responsibilities for the Program, and specifying managers follow a code of ethics.

Program staff indicated that the identified best practices above are addressed through the Program's other governing documents, even if they are not currently specified in the Policies.

Management should review best practices, including those identified above, and determine which ones make sense for the City to include in its Policies.

(Recommendation 1)

6 Conclusions and Recommendations

The first objective of this review was to determine if the Program complies with its Policies and if its Policies comply with provincial regulations under the Municipal Government Act.

To determine this we assessed various areas of the Policies for compliance based on Program reports, processes, and interviews. We also reviewed provincial regulations in detail and assessed them against the Policies. We found that the Program substantially complies with the Policies and that the Policies comply with provincial regulations under the Municipal Government Act.

We found minor exceptions to Program compliance with the Policies in the areas of performance measurement and annual reports. We have addressed these exceptions with a recommendation to revise the investment policies where they are relevant **(Recommendation 1)** and a recommendation to include all required information in annual reports where the Program has not complied **(Recommendation 2)**.

The second objective of this review was to determine if the Policies are effective. We found that the Policies are effective with some opportunities to improve around clarity and updating for current best practices. We have provided a recommendation to revise the investment policies (**Recommendation 1**).

We have made the following two recommendations to address compliance issues and opportunities to improve the Policies. City Administration has provided its responses to these recommendations.

Recommendation 1 – Revise Investment Policies

We recommend that the Deputy City Manager and Chief Financial Officer, Financial and Corporate Services revise the City’s investment policies to ensure they are clear and reflect all relevant current best practices.

Management Response

Accepted

Action Plan: An updated investment policy is planned for the first half of 2019. One of the key projects on the 2018 investment management work plan is completing asset mix studies for the City’s various funds. Once this work has been completed, a policy update will be brought for City Council approval.

Planned Implementation Date: June 30, 2019

Responsible Party: Chief Investment Officer

Recommendation 2 – Include All Required Information in Annual Reports

We recommend that the Deputy City Manager and Chief Financial Officer, Financial and Corporate Services ensures that his staff and those preparing annual reports for the investment program include all information in the annual reports as required by the City’s investment policies.

Management Response

Accepted

Action Plan: The items noted by the Office of the City Auditor will be incorporated within the 2017 Investment Committee Annual Report.

Planned Implementation Date: April 30, 2018

Responsible Party: Chief Investment Officer

We would like to thank investment program management and staff who worked with us on this review for their cooperation and assistance.

Appendix 1 – Risk Assessment and Methodology for Review

Risk Assessment

We conducted a variety of risk identification and assessment activities including:

- Risk identification interviews with staff;
- Research into relevant topics; and
- Review of investment management reports and policy documents.

As a result of this risk assessment, we developed the objectives and criteria for this review.

Methodology

We used the following methods to gather evidence and conclude on the objectives for this review:

- Reviewing related City policies, procedures, and bylaws;
- Reviewing relevant provincial regulations under the Municipal Government Act;
- Conducting external research;
- Discussions with management and supervisory employees;
- Interviews with Investment Committee members; and
- Testing financial statements and reports for compliance with the City's investment policies.