

Committee of the Whole Meeting Agenda

Monday, February 1, 2021, 2:00 p.m.

Remote meeting live streamed
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Changes to the original agenda are noted with an asterisk "*".

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Pages

1. Notice of Electronic Participation

1.1. Committee of the Whole

This meeting will be held by Electronic Participation in accordance with City of Guelph Procedural By-Law (2020)-20515.

2. Call to Order - 2:00 p.m.

2.1. Disclosure of Pecuniary Interest and General Nature Therefore

3. Staff Recognitions

3.1. Canadian Payroll Association - Payroll Compliance Practitioner Program Certification

Mihaela Vulpin, Clerical Assistant III, Operations

3.2. Association of Ontario Road Supervisors - Road Supervisor Certification

John Gaddy, Supervisor, Public Works

3.3. Municipal Law Enforcement Officer Certification

John Bailey, By-law Compliance Officer

4. Service Area - Corporate Services

Vice Chair - Mayor Guthrie

5. Items for Discussion - Corporate Services

The following items have been extracted from Consent Agenda and will be considered separately. These items have been extracted either at the request of a member of Council or because they include a presentation and/or delegations.

5.1. Prudent Investor Standard Analysis and Recommendations - 2021-31

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Staff Presentation:

Shanna O'Dwyer, Manager, Financial Reporting and Accounting

Recommendation:

1. That staff be directed to ready the City for the implementation of the Joint Investment Board option available under the Prudent Investor Standard while monitoring the legislative landscape for additional opportunities that may arise from an anticipated provincial review of municipal investment legislation; and
2. That staff be directed to report back to Council with final Investment Policy recommendations within two years, subject to the anticipated provincial review; and
3. That the proposed amendments to the current Investment Policy to expand access to professionally managed investments through ONE Investment be approved.

6. Service Area Chair and Staff Announcements

7. Service Area - Audit

Vice Chair - Mayor Guthrie

8. Items for Discussion - Audit

The following items have been extracted from Consent Agenda and will be considered separately. These items have been extracted either at the request of a member of Council or because they include a presentation and/or delegations.

8.1. 2020 Internal Audit Summary and 2021 Work Plan - 2021-03

44

Staff Presentation:

Karl Hutchinson, General Manager, Internal Audit

Recommendation:

That the report titled '2020 Internal Audit Summary and 2021 Work Plan' be approved.

9. Service Area Chair and Staff Announcements
10. Adjournment

Staff Report



To	Committee of the Whole
Service Area	Corporate Services
Date	Monday, February 1, 2021
Subject	Prudent Investor Standard Analysis and Recommendations

Recommendation

1. That staff be directed to ready the City for the implementation of the Joint Investment Board option available under the Prudent Investor Standard while monitoring the legislative landscape for additional opportunities that may arise from an anticipated provincial review of municipal investment legislation; and
 2. That staff be directed to report back to Council with final Investment Policy recommendations within two years, subject to the anticipated provincial review; and
 3. That the proposed amendments to the current Investment Policy to expand access to professionally managed investments through ONE Investment be approved.
-

Executive Summary

Purpose of Report

To provide Council with analysis and recommendations regarding the Prudent Investor Standard (PI) options available under the Municipal Act (the Act) and Regulations.

Key Findings

As the City grows, and implements sustainable, long-term financial management practices, the City's investment portfolio is increasing and therefore requires a review to understand the options available for managing these funds in the most effective model. In recent years, the province announced new PI legislation that would enhance a municipality's ability to diversify holdings subject to specific governance structures being implemented. Please refer to the December 2020 [Information Report](#) for background on the options available.

Staff sought professional expertise to review the options available, consider earnings potential and associated management costs and to ultimately provide future-looking advice on the City's investment management function. Staff also completed a municipal comparison and interviewed staff at specific municipalities regarding their investment management choice and experience to date.

Based on the analysis included in Attachment-1 to this report, and City staff investigation and assessment of readiness of internal practices, it is recommended

that in the short-term, the City should continue to invest funds not immediately required in accordance with Section 418 of the Act and Part I of Ontario Regulation 438/97 (O.Reg). For greater clarity, this means the City should continue to use the legal list legislation while staff ready the City to move to an enhanced standard in the future. The consultant's report shows however, that the City should amend its current Investment Policy to increase the externally managed portion of its investment portfolio.

The Investment Board (IB) option under PI has significant financial and operational risk associated with it, and would require additional staff resources as well as the creation of a paid, skilled oversight board to manage effectively. Staff have determined this is not a financially efficient model for Guelph and it should therefore be eliminated from further consideration. It would be more financially prudent to consider a joint model where municipalities share in the cost of professional management and governance.

Staff should continue to prepare the City to opt-in to PI through the Joint Investment Board (JIB) option by continuing to develop and refine long-term cash flow forecasting capabilities and investigating appropriate investment policy options under PI. The City should also monitor the landscape for amendments to investment options under the Municipal Act, consider any new options that may become available, and provide a report to Council comparing the PI JIB option with any new options that emerge within two years' time.

Financial Implications

The proposed amendment to the current Investment Policy to increase the amount of the portfolio that can be invested in the professionally managed funds through ONE Investment (ONE) should provide greater returns for the City based on the analysis. Caution however should be used as past historical performance does not guarantee future rate returns.

Report

This report is provided in follow-up to the December 11, 2020 [Information Report 2020-217 - Prudent Investor Standard for Municipal Investments](#).

Background

Sections 418 and 418.1 of the Act and the O.Reg set the parameters under which municipalities may invest funds not immediately required. Allowable investments under Section 418 and Part I of the O.Reg are referred to as the legal list. Legal list investments are limited to Canadian federal, provincial and municipal governments and associated entities, or government-guaranteed bonds, short-term fixed-income securities issued by Canadian chartered banks and credit unions, and Canadian equities accessed through the ONE Canadian Equity portfolio. Investing under the legal list is the default investment position for municipalities, and the City's current investment policy is built on the legal list.

On January 1, 2019, Section 418.1 of the Act and the associated changes to the O.Reg (Part II) came into effect, giving municipalities that meet the financial eligibility criteria outlined in the Act the option to opt-in to PI. Opting-in to PI will give municipalities the ability to invest in any security, and requires the municipality

to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making an investment.

Criteria for Opting-In to PI

The financial eligibility criteria are:

- In the opinion of the treasurer, the municipality has at least \$100,000,000 in money and investments it does not require immediately; or
- The municipality has \$50,000,000 in net financial assets as reported in Schedule 70 of the most recent Financial Information Return (FIR).

The Act provides an interpretation of money not immediately required, which includes money in a sinking, retirement or reserve fund, money raised or received for the payment of a debt of the municipality or interest on the debt, and proceeds from the sale, loan or investment of any debentures.

The City has reserves and reserve funds well in excess of the minimum of \$100,000,000 required under the legislation. City reserves reported on the December 31, 2019 audited financial statements totaled \$43,901,000, and City reserve funds totaled \$206,217,000.

The City reported net financial assets of \$167,154,000 on the 2019 FIR, and therefore exceeds the minimum threshold of \$50,000,000 required by the legislation.

How to Opt-In to PI

In order to opt-in to PI, Council must pass a by-law and in that by-law set out the effective date of the by-law (eligibility criteria must be met on the day the by-law is passed).

How to Opt Out Of PI

According to sub-section 418.1(5) of the Act, a by-law passed to opt-in to PI cannot be revoked, and PI continues to be in effect whether or not the municipality continues to meet the financial eligibility criteria.

A municipality may only withdraw from PI through a regulation of the Lieutenant Governor in Council (an amendment to the O.Reg), and in that case the regulation will prescribe transitional rules that apply to the municipality.

For this reason, the municipal sector as a whole is being very cautious about opting-in to PI as there is no ability to reverse this decision easily and the cost to maintain the PI model is significant.

Governance Structure under the Legal List

Municipalities investing funds not immediately required under the legal list do so in accordance with an investment policy approved by Council. Funds can be self-managed by the municipality or by an investment manager or managers who can be retained to manage the funds on behalf of the municipality. Whether self-managed or externally managed, it is the treasurer's responsibility to ensure compliance with Council's approved investment policy, and to report any inconsistency to Council within 30 days after becoming aware of it.

Governance Structure under PI

Municipalities that opt-in to PI have two governance options available to them:

- i. Form an IB for the municipality; or
- ii. Join an existing JIB.

There is only one JIB in existence at this time, and that is the ONE JIB, of which six municipalities are members. There are only two municipalities that have opted-in to PI using the IB model – Toronto and Barrie.

Under PI, Council would still be responsible for approving the investment policy for the municipality, and the IB or JIB is responsible for developing an investment plan in alignment with that policy, and for implementing it.

The IB or JIB has control of investment decisions in alignment with Council's approved policy, and is responsible for ensuring policy compliance.

The analysis in the attached consultant's report sets out the estimated costs of forming and operating an IB and of participating in the ONE JIB, as well as some of the potential benefits and pitfalls associated with either option.

Municipal Consultations

City staff connected with staff at the City of Barrie, which has opted-in to PI and formed their own IB, and the Region of Peel who is still considering its options.

Through this consultation, staff learned that the province has committed to re-convening a committee to review the sections of the Act and regulations that prescribe municipal investment powers to determine if there are other options that may be added that allow municipalities access to an expanded selection of investments without the more costly governance requirements of an IB or JIB.

One such option may be the outsourced chief investment officer (OCIO) model. An OCIO takes an organization's approved investment policy which establishes the needs, goals, and risk tolerances of the organization, builds a plan reflective of those policy goals decisions, and then selects and monitors the investment managers who manage the portfolio.

ONE

ONE was formed in 1993 as ONE – The Public Sector Group of Funds by Local Authority Services (LAS) and CHUMS Financing Corporation (a subsidiary of the Municipal Finance Officers' Association of Ontario) to provide investment options for Ontario municipalities. ONE provides several options for municipalities investing under the legal list, as follows:

Short term

- High Interest Savings Account (for 1+ month investments)
- Money Market Portfolio (for 1 to 18 months investments)

Medium term

- Canadian Government Bond Portfolio (18 months to 3 years investments)
- Canadian Corporate Bond Portfolio (4+ years investments)

Long term

- Canadian Equity Portfolio (5+ years investments)

Municipalities in the ONE JIB have access to the above medium and long-term portfolios (short-term cash flow management is outside of the scope of the JIB), in

addition a Global Equity Portfolio which is only available to municipalities who have opted-in to PI.

Analysis

The City engaged Rodgers Investment Consulting (RIC) to undertake a preliminary analysis of the options available under the legislation. RIC's report is attached as Attachment-1.

Four options were considered in this analysis:

- i. Continue to invest under Section 418 of the Act (legal list), and continue to self-manage a significant portion of the City's portfolio;
- ii. Continue to invest under Section 418 of the Act (legal list), and expand the managed portion of the City's portfolio;
- iii. Opt-in to PI and form an IB for the City; or
- iv. Opt-in to PI and join the ONE JIB.

The analysis is based on historical returns and actual costs (when known) or estimated costs (when not known). RIC points out that a limitation of the cost analysis is that the City does not have a dedicated investment professional(s) managing the City's portfolio. This task is part of the jobs of multiple staff in the Finance department, and the City does not have staff with specialized investment expertise managing the portfolio. The internal management costs have not been estimated.

RIC concluded that the City would be well served by opting-in to PI, while the financial decision as to whether or not to form its own IB or join the ONE JIB is less clear; however, given the significant financial and operational risks involved with setting up and operating an IB as outlined in the report, and the fact that the City would most likely need to hire a dedicated senior investment specialist if the IB option is pursued, staff recommend that the IB option is not the most effective for Guelph.

Based on the historical analysis, RIC also concluded that the City would have been better served utilizing the professional management of ONE for the management of the long-term portfolio in accordance with the O.Regs (legal list).

The City's Readiness for PI

The City meets both of the financial eligibility criteria under the legislation for opting into PI (meeting only one of the two is required).

Staff have done significant foundational work that will contribute to readiness to implement PI, including implementation of the reserve and reserve fund strategy and capital funding strategies which have increased confidence in long-term planning and have increased the size of the long-term investment portfolio. The City is now at a point where a review of the investment portfolio structure and the new options available under the Act is important for future sustainability including integrating debt and investment planning to access longer-term financing options.

In addition to the work already done, staff are continuing to develop and refine long-term cash flow forecasting capabilities. Having a reliable long-term model for forecasting cash needs in place is an essential foundation for investment planning under PI.

In addition to long-term cash flow forecasting capability, a new investment policy will be required for the City under PI.

For this reason, the City is not currently in a position to implement PI through the ONE JIB.

Current Investment Policy Amendments

While staff continue to work on the foundational structures needed for participation in PI through the ONE JIB, an interim step of amending the City's current Investment Policy to increase access to the ONE legal list professionally managed funds is recommended. The revised draft Investment Policy included in Attachment-2 (presented with changes tracked) contains the following amendments:

Investment Policy Classification	Portfolios Included	Current Portfolio Limit	Proposed Portfolio Limit
Joint Municipal Investment Pools – Bonds	Canadian Government Bond Portfolio	0%	40%
Joint Municipal Investment Pools - Bonds	Canadian Corporate Bond Portfolio	15%	40%
Joint Municipal Investment Pools - Equity	Canadian Equity Portfolio	5%	20%

The Investment policy has also been formatted in alignment with the City's current corporate policy template to comply with Accessibility for Ontarians with Disabilities standards resulting in other minor changes.

Financial Implications

The proposed amendment to the current Investment Policy to increase the amount of the portfolio that can be invested in the professionally managed funds through ONE should provide greater returns for the City based on the analysis. Caution however should be used as past historical performance does not guarantee future rate returns.

Consultations

None noted.

Strategic Plan Alignment

This report supports the Working Together for Our Future Priority of exploring service delivery models and partnerships to ease taxes for residents and businesses.

Attachments

Attachment-1 Analysis of Long-Term Investment Options

Attachment-2 Proposed Investment Policy

Departmental Approval

N/A

Report Author

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**Analysis of Long-Term
Investment Options
December 2020**

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Analysis of Investment Options

Guelph currently invests funds not needed immediately in accordance with section 418 of the Municipal Act and Part I of Ontario Regulation 438/97 (referred to throughout this report as the legal list) and is now considering whether it should move to a Prudent Investor (PI) regime.

Legal List Investments

As of June 30, 2020 Guelph held approximately \$220 million in long-term investments. Of this amount approximately 70% was Self Managed and approximately 30% was held in ONE Investment portfolios.

Self Managed Investments

In the 70% of the long-term investments that are self managed Guelph staff make the decisions on what to invest in. These decisions are made with the advice of a number of Financial Advisors from various Investment Dealers. These Investment Advisors are not authorized to manage portfolios on a discretionary basis and are held to a Suitability Standard (recommendations must be suitable).

ONE Investment Portfolios

The 30% of the long-term assets that are held in the ONE Investment Portfolios comply with the Legal List and are managed on a discretionary basis by firms registered as Portfolio Managers. Due to the discretionary nature of these portfolios these firms are held to a Fiduciary Standard of Care and must act in the client's best interest.

Legal List Cost Comparisons

To determine which of these two approaches has been better for Guelph we examined both the cost of each option and the returns earned.

From a cost perspective it may appear that the ONE option is more expensive since the fees are clearly disclosed and fully transparent. The fees are charged as a percentage of assets and the portfolios' full compliance with the legal list are guaranteed by ONE Investment. The following fees apply to each of the ONE portfolios and these fees include investment management, custody, compliance and administrative costs.

ONE Government Bond – 0.40%

ONE Corporate Bond – 0.45%

ONE Canadian Equity – 0.60%

By contrast there is no fee applied by the Investment Dealers to the self managed portions of the portfolio. Compensation to the Investment Dealers is embedded in initial price of the security and is not disclosed. Staff time is also required for this component but no estimate of staff cost has been made for the purpose of this report.

Legal List Return Comparisons

For the return comparisons we requested time weighted rates of return from each of the Investment Dealers so that it could be compared to the time weighted rate of return of the ONE portfolios, net of fees. This detailed analysis is included in Appendix One.

To calculate the approximate return of the self-managed portfolios we used a weighted average based on the allocation of each Investment Dealer to the short, mid, and long-term bond sectors.

Overall, it appears that significant value could be added by expanding the professionally managed component of the portfolio given the strong and less volatile returns as demonstrated through the comparators.

PI Regime

Guelph now has the ability to opt in to the Prudent Investor Standard for its long-term investments either by establishing its own Investment Board (IB) or joining a Joint Investment Board (JIB).

If establishing an IB or joining an existing JIB the City establishes its own Investment Policy and the IB or JIB then implements that Policy.

Costs to Establish an Investment Board

There are significant costs involved in establishing and running an IB. In 2017 the City of Toronto approved a budget of \$557,000 to establish its IB. This amount included \$135,000 of staff time and support and \$72,500 in Board member remuneration based on an anticipated five meetings in 2017. The document can be found at <https://www.toronto.ca/legdocs/mmis/2017/ex/bgrd/backgroundfile-101513.pdf>¹.

It is likely that Guelph could establish an IB for less money, particularly if Toronto was willing to share their experience and learnings. However, it would be prudent to estimate the up-front costs at \$250,000 to \$300,000 at a minimum and \$600,000 at a maximum. These costs would be incurred to recruit members of the Board, conduct robust investment manager searches, develop governance documents and administrative procedures, as well as legal fees to review all documentation.

The ongoing costs of an IB would normally be offset against investment earnings. Toronto's estimated annual costs are approximately \$215,000 per annum. These annual costs include Board Compensation and administration. They do not include investment management and custodial fees which are offset against investment earnings. While Guelph's costs could be somewhat lower in absolute dollars it would likely be higher when measured as a percentage of assets. Toronto's long-

¹ 2017.EX23.2 Report for Action, Executive Committee. Establishment of an Investment Board Attachment #2

term General Fund investments were approximately \$3 billion in 2019 which would give them significant fee negotiating power with their external managers, compared to Guelph's approximately \$220 million in long-term funds.

An IB may also present challenges in recruiting members of sufficient expertise and experience. The following excerpt from a City of Toronto Report (February 21, 2017) indicates the qualifications required of members.²

D. Qualifications of Members

It is important that Investment Board members are experienced and skilled to help ensure high quality decision-making consistent with their fiduciary responsibilities. The qualification of members is particularly important given the amount of the portfolio they will be responsible to invest and their delegation of authority in this regard.

Public members of the Board shall collectively represent a range of skills, knowledge and experience to discharge their duties in an effective manner including:

- Executive level experience in a major public or private organization;
- Senior level experience in the investment industry such as the management of institutional portfolios including pension funds, endowments, foundations, mutual funds, and closed-end funds;
- Professional skills relating to investment and/or debt management as well as an understanding of risk and financial administration within the framework of the PI standard;
- Post-graduate degree in any one of the fields of: finance, business, economics, risk management, accounting, public administration or related fields that may include certification such as CFA designation, Canadian Investment Manager Certification or equivalent;
- Possession of sound judgement and knowledge of good governance; and
- Understanding of the principles of public accountability and integrity. A minimum of three (3) board members must have senior level experience in the investment industry such as the management of institutional portfolios including pension funds, endowments, foundations, mutual funds, and closed-end funds.

The senior level experience in the investment industry may be difficult to find outside of Toronto, Montreal and Vancouver.

² Toronto 2017.EX23.2 Report for Action, Executive Committee. Establishment of Investment Board

In order to compare the potential costs of an IB and JIB we will make the following assumptions;

- Average portfolio size - \$235 million
- Initial costs to establish an IB - \$300,000 to \$600,000
- Ongoing annual costs of IB - \$150,000 to \$225,000
- No staff support costs included
- Annual investment management and custody fees - \$750,000 to \$850,000*
 - Assumes 25% of portfolio at 0.5% (equity) and 75% of portfolio at 0.25% (fixed income).
- Total ongoing annual costs - \$900,000 or 0.38% of \$235 million to \$1.075 million or 0.457% of \$235 million

*In Toronto these costs are incurred but offset against investment earnings and are therefore not disclosed publicly.

These estimates assume that Guelph, on its own, would be able to negotiate management and custody fees similar to what ONE has negotiated. It also assumes that the costs of establishing its own IB could be significantly less than what Toronto incurred. Given the significant difference in portfolio size between ONE and Guelph and between Toronto and Guelph, it would be reasonable to take the high estimate and potentially add a contingency amount.

Joining an existing JIB

If Guelph prefers to join an existing JIB rather than take on the financial costs and potential risks of establishing its own IB the only option currently available is the ONE JIB. ONE Investment has spent over a year developing a JIB with a number of founding municipal partners³. ONE has absorbed all of the upfront and initial costs and will recover those over time from the annual fees.

To join the existing ONE Investment JIB there are no initial costs for Guelph to establish the Board, recruit members, undertake a management search or establish governance and administrative frameworks. The annual fees cover the initial set-up and the ongoing cost of operating the JIB. The fees are as follows:

ONE Government Bond – 0.32%

ONE Corporate Bond – 0.37%

ONE Canadian Equity – 0.52%

ONE Global Equity – 0.72%

Assuming the same asset mix of 25% equity and 75% fixed income that is in place currently, this would result in annual fees of approximately \$980K or 0.417% of assets. With the exception of the Global Equity, these fees are lower than what is

³ Whitby, City of Kenora, District Municipality of Muskoka and towns of Bracebridge, Huntsville and Innisfil

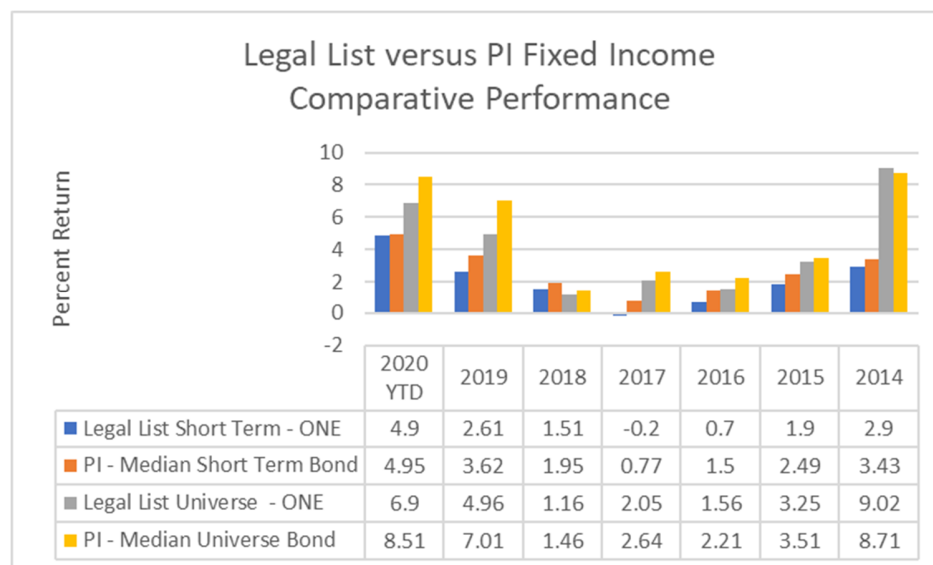
currently charged on the ONE legal list portfolios. We have not included Global Equity in these fee calculations since Global equity is not a permitted investment under the Legal List so there is no available comparison. If Global equity was included the cost would be marginally higher, depending on the size of the allocation, but as discussed later the potential increase in returns would also be significant.

In the best-case scenario establishing its own IB could result in slightly lower annual costs of 0.04% (4 basis points), although Guelph would still incur substantial start-up costs and would have to accept the risk of cost overruns or unexpected costs on an ongoing basis.

At the other end the annual costs could be 0.04% higher (4 basis points) than joining an existing JIB.

Return Comparisons of Legal List and PI

The following charts compare the professional management historic performance between the legal list options and the broad universe of professional management which would be available under PI. Although a Municipality could retain professional management they would still be restricted to the legal list and be unable to access equities directly or the longer-term corporate bonds that ONE can access.

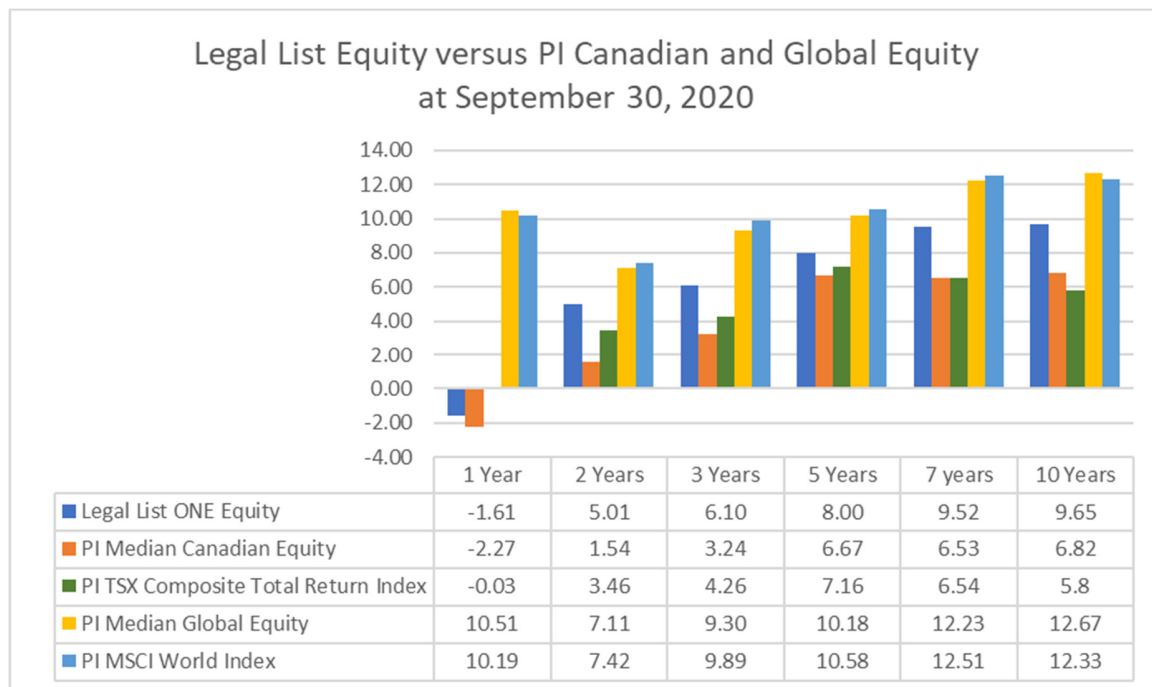


Within the short-term fixed income sector, the PI approach, represented by the Median Short Term Bond performance has performed better than the Legal List performance, represented by the ONE Short Term Government Bond Fund.

The Median Universe Bond performance, which includes bonds with longer dated maturities, is the performance of the institutional investment manager ranking at the 50th percentile. The Median Universe manager has outperformed the legal list manager in all time periods with the exception of 2014.

The reason for this outperformance is the wider availability of fixed income securities, especially corporate issues and the greater flexibility of maturity dates. All bonds held within all portfolios are Investment Grade rated.

Including Global equities, which can only be done under the PI regime, would have also improved performance⁴. All returns in the equity charts are presented in Canadian dollars and are gross of fees in order to provide direct comparisons.



We don't know what the future returns will be but based on history we can expect global equity markets to outperform Canadian equity markets on a risk adjusted basis.

Global equity markets are more diversified than Canadian equity markets providing investors with a broader array of large companies for investors to select from. In addition, the Canadian equity markets are heavily biased toward the Financials, Materials (including gold) and Energy sectors resulting in a more commodity-based investment environment. The following table demonstrates the different equity market sector structures.

Sector	MSCI World Weighting	S&P TSX Composite Weighting
Information Technology	21.6%	10.3%
Healthcare	13.5%	0.9%

⁴ Legal List equity investments include restrictions which exclude some securities within the broader Canadian equity universe

Sector	MSCI World Weighting	S&P TSX Composite Weighting
Financials	12.1%	28.4%
Consumer Discretionary	11.9%	3.5%
Industrials	10.4%	12.5%
Communication Services	9.2%	5.2%
Consumer Staples	8.1%	4.4%
Materials	4.5%	15.5%
Utilities	3.4%	5.3%
Real Estate	2.8%	3.2%
Energy	2.4%	10.8%

The Sharpe Ratio is a common method of measuring return per unit of risk. It measures the excess return over the risk-free rate per unit of volatility. The higher the number the better. For Canadian equities the Sharpe Ratio is 0.61 over the past 10 years. Global equities had a Sharpe Ratio of 1.13 over the same period. The added diversification offered by Global equities would add to the risk adjusted returns.

Conclusions

The detailed analysis contained in Appendix One demonstrates that Guelph would have been better served utilizing the professional management of ONE for the management of the long-term portfolio in accordance with the legal list.

The options for Guelph are as follows:

Comparisons	Control and Management	Investment Options	Initial Costs	Estimated Costs	Internal Admin & Staff Costs	Return Potential
Self-Managed	Guelph	Legal List	None	^Unknown	Unknown	Lower
Legal List Professional Management	Guelph	*Legal List	None	\$1.1 mil.	Minimal	Higher
IB	IB	PI	\$300K - \$600K	\$0.9 mil.	Minimal	Highest
JIB	JIB	PI	None	\$0.98 mil.	Minimal	Highest

*The Legal List for ONE includes Canadian Equity and longer term corporate Fixed Income

^The cost is embedded in the purchase price and not disclosed.

Guelph would be well served moving to the PI regime. It would offer the opportunity for higher risk adjusted returns and provide professional management of long-term assets.

The decision between an IB or a JIB is less clear cut. The cost of establishing an IB is assumed to be at least \$300K but based on the experience of Toronto could be significantly higher. In the case of Toronto, they had a reasonably robust internal investment department to assist in the management of the process and budgeted over \$550K. Guelph does not have any resources fully dedicated to investment management – it is part of the jobs of three people in the Finance department.

The difference between the estimated annual costs for either an IB or JIB is relatively small. In the case of a JIB the annual expenses are known and can be easily forecast once the asset allocation has been determined. In the case of an IB these expenses can only be estimated and must be negotiated with each investment manager and custodian.

There is a lower risk of unexpected costs or delays with a JIB since it has already been established.

Appendix One, Return Comparisons

Methodology

The return data in this portion of the report has been obtained from a number of sources.

Information on the returns of the ONE Canadian Equity, ONE Government Short Term Bond and ONE Corporate Bond portfolios, which are legal list professionally managed portfolios, were obtained directly from ONE Investments. These returns are net of management fees and trading expenses.

Information on returns from portfolios held at Investment Dealers (TD, NBF, BMO, & CIBC) were obtained directly from the firms. These are net of trading costs. It is our understanding that there are no management fees for these accounts. Return information was requested only on the marketable securities. The decision to use only marketable securities (which excludes GICs and term deposits) was made to ensure a fair comparison. A portfolio being managed under PI would not use GIC or term deposit investments due to the lack of transparent liquidity and pricing prior to the maturity date. As a result, it would create an unfair comparison, and be biased toward the GIC's during periods of market declines and biased towards the marketable securities during periods of positive returns since GIC's are carried at book value which does not change.

Information on the Median Returns of institutional managers was obtained from Global Manager Research Database, a Canadian Investment Manager and Performance Measurement data base. The firm was established in 1986 and tracks over 300 institutional investment managers.

The bond market is broken into three maturity sectors, short term (1-5 years), mid term (5-10 years) and long term (10+ years).

Performance was compared on a calendar year basis in order to capture the volatility of returns. The year-to-date returns are to September 30, 2020.

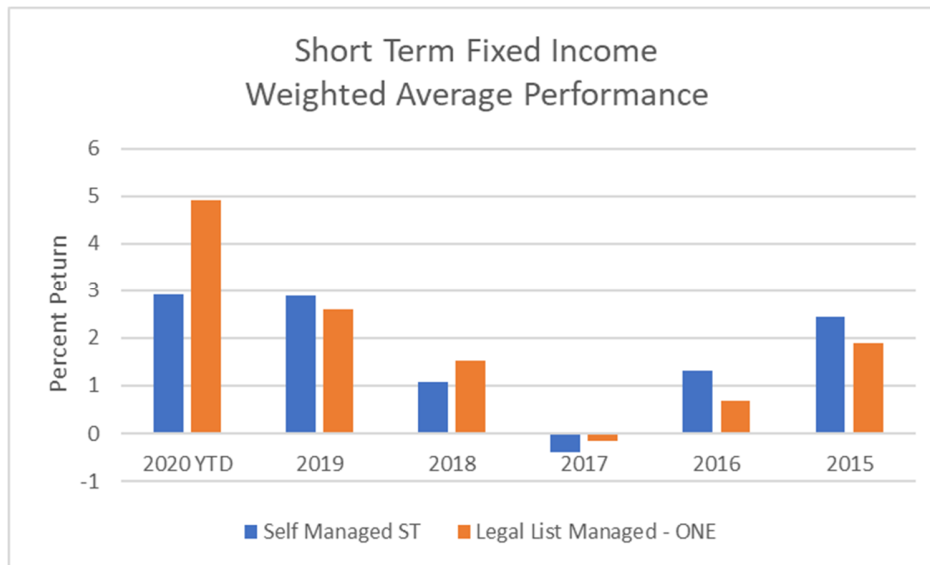
Fixed Income Investments

Guelph utilizes one of the two available legal list fixed income investment strategies offered by ONE Investment, the Corporate Bond Strategy. This strategy allows for longer term corporate bonds than would be available directly to Guelph under the legal list. At September 30, 2020 this portfolio has an exposure of 71% to Corporate Issues with a duration of 5.81 Years and average maturity of 7.57 Years.

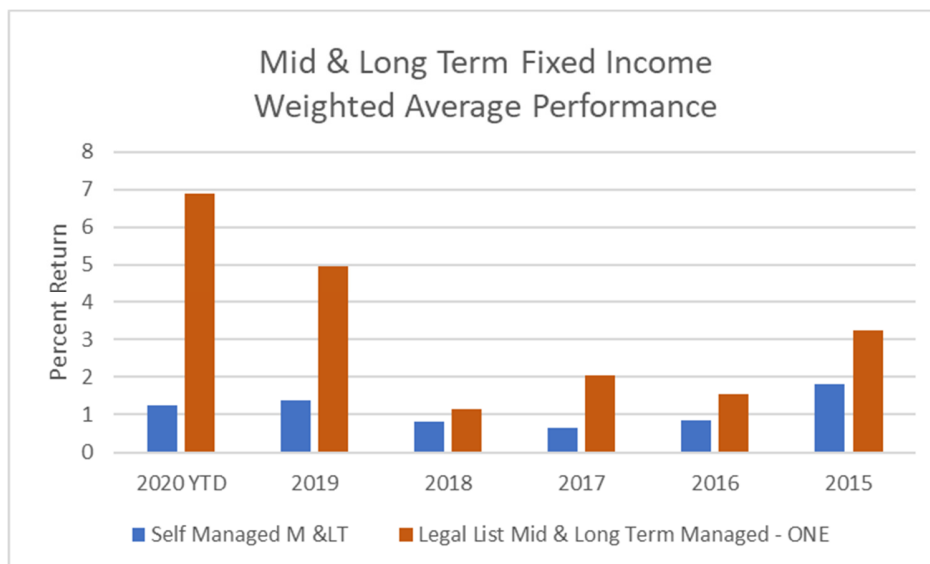
Performance Comparisons

We have estimated the returns for Short Term fixed income and Medium and Long-Term fixed income using a weighted average based on the allocation of funds to each of the term sectors and allocations to the various investment dealers Guelph deals with.

The following charts represent the returns of the fixed income portfolios invested in legal list securities. The Legal List – ONE is the legal list portfolios offered by ONE Investments. The Self-Managed are the portfolios managed by Guelph staff with the advice of the Investment Dealers.

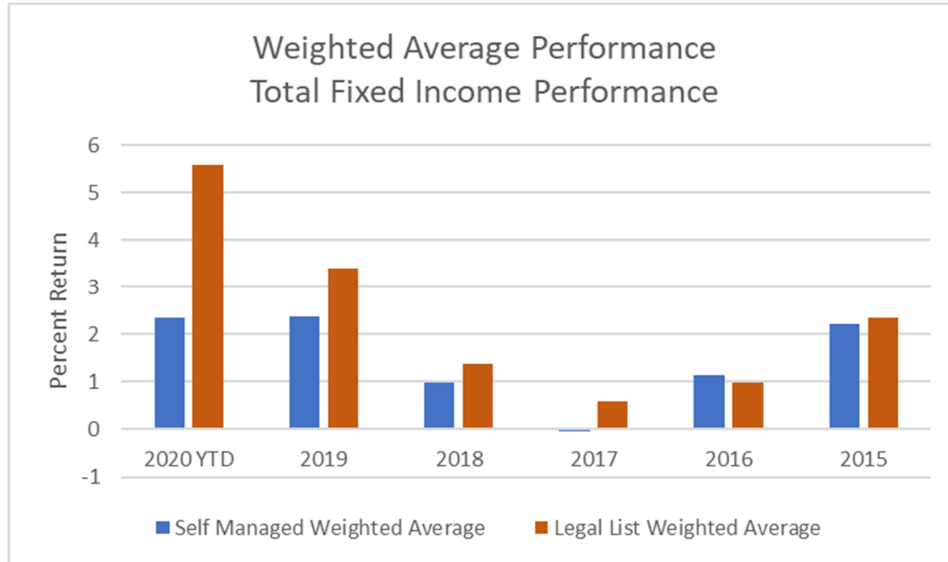


Within the Short Term Fixed Income (those with maturities of 1-5 years), the performance of both components has been similar.



Within the Mid and Long Term components, the Legal List professionally managed portfolio has significantly outperformed the Self Managed component.

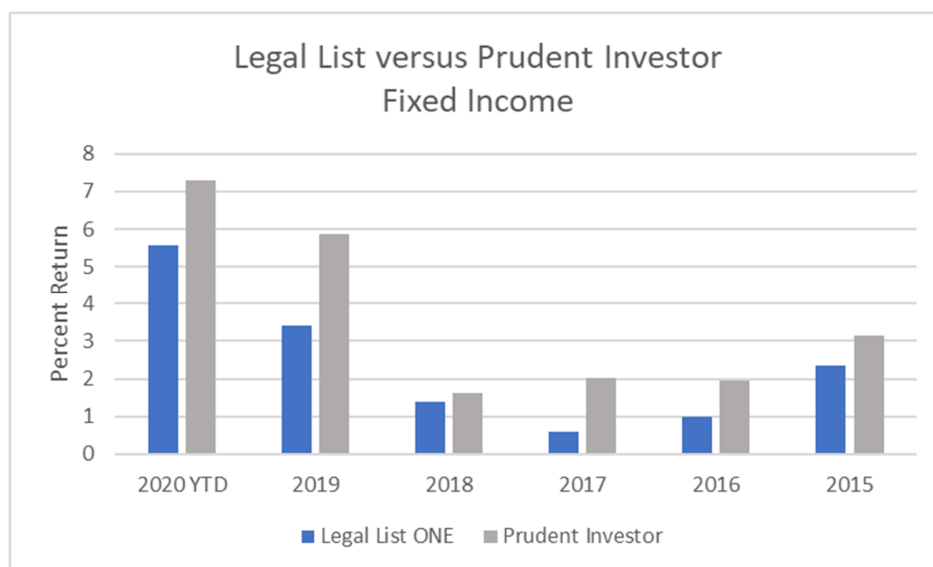
Of the marketable securities, approximately 66% were invested in Short Term issues and 34% were invested in Mid and Long Term securities. The weighted average Total Portfolio estimated performance is shown in the following chart.



This gives a 5-year compounded average return at December 31, 2019 of 1.44% for the Self-Managed portfolio and 1.79% for the Legal List professionally managed portfolio. The result is a 0.35% difference in the average annual performance.

On a portfolio value of \$200 million that would represent approximately \$698K annually in additional earnings while still remaining with legal list investments.

When considering the difference in returns possible from a move to PI we have used the Fixed Income Median performance of institutional managers in the same 66%/34% allocation. The Median performance is the performance of the manager that ranked at the 50th percentile. All of the securities held in these Median portfolios are investment grade.



In all periods, investing in accordance with a PI regime would have resulted in significantly better fixed income returns.

The five-year annualized performance at December 31, 2019 under a PI regime would have been 2.47% compared to the five-year Legal List of 1.79%, or 0.68% higher return.

On the same hypothetical \$200 million portfolio this would have represented approximately an additional \$1.36 million on average annually more than on the legal list professionally managed and just over \$2 million more than the legal list self-managed portfolio earned.

Equity

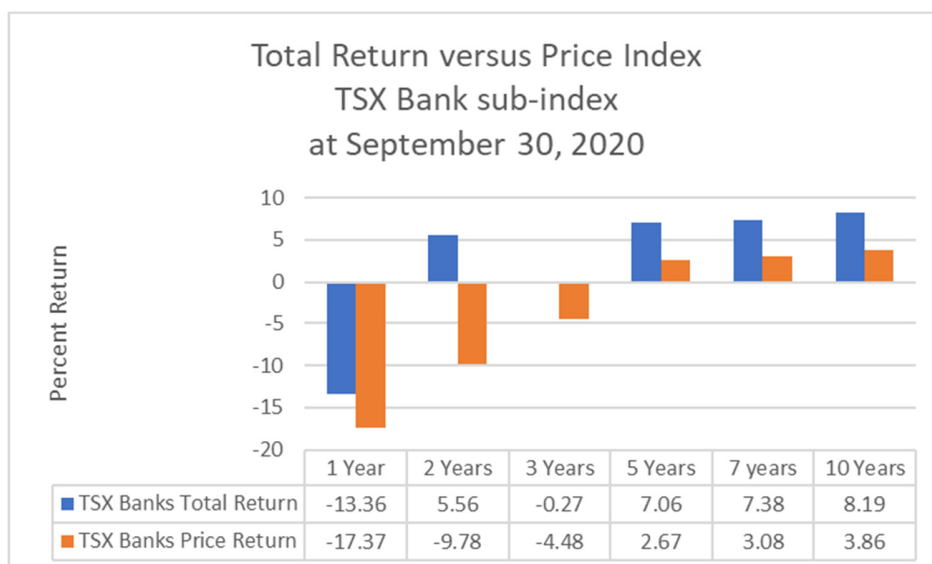
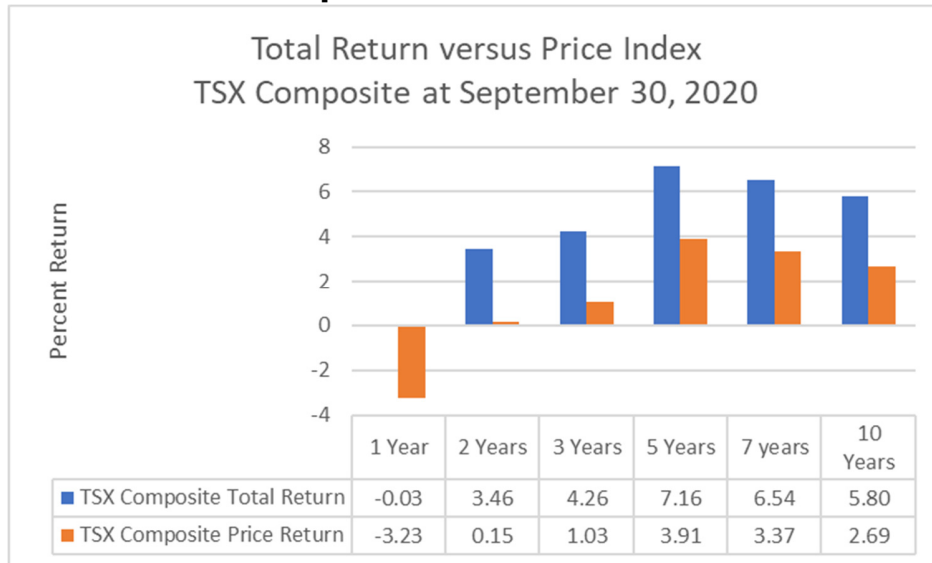
Guelph has invested in a number of equity substitutes using Principle Protected Notes (PPN's) in addition to the ONE Canadian Equity Fund.

The PPN's are linked to the TSX Composite index and the TSX Bank index and have maturity dates ranging from September 2025 to September 2028. These are carried at book value on the CIBC statements.

A PPN is a bank deposit note whose return is linked to the performance of a particular stock index. In the case of the four PPN's held by Guelph the index they are linked to is the Price Index, not the Total Return Index which includes dividends. The difference in return between the Price Index and the Total Return Index can be substantial and compounds over time as shown in the following charts.

While a PPN may protect the original capital value of the investment in the short term, this protection is not needed when the maturity dates are more than five years away. They can be sold prior to maturity in the secondary markets but this would normally entail a price that is discounted from the imputed value.

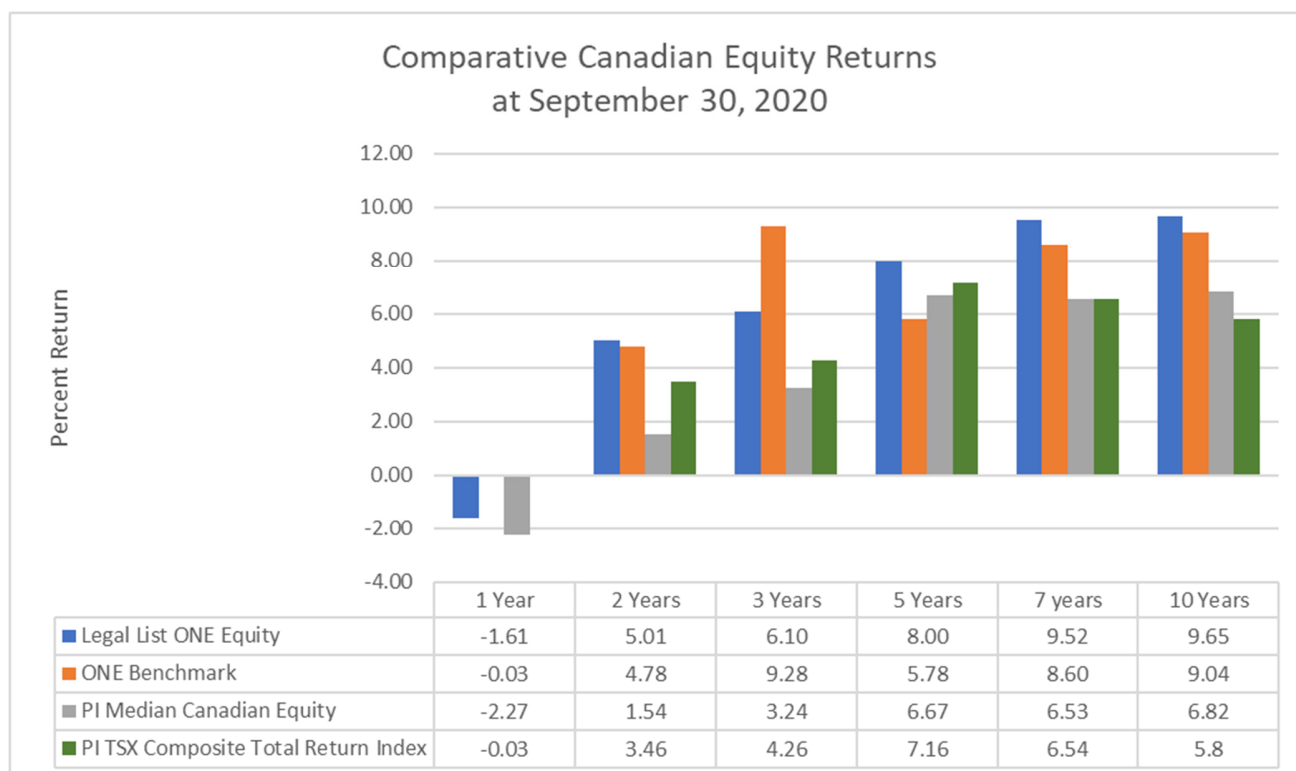
Performance Comparisons



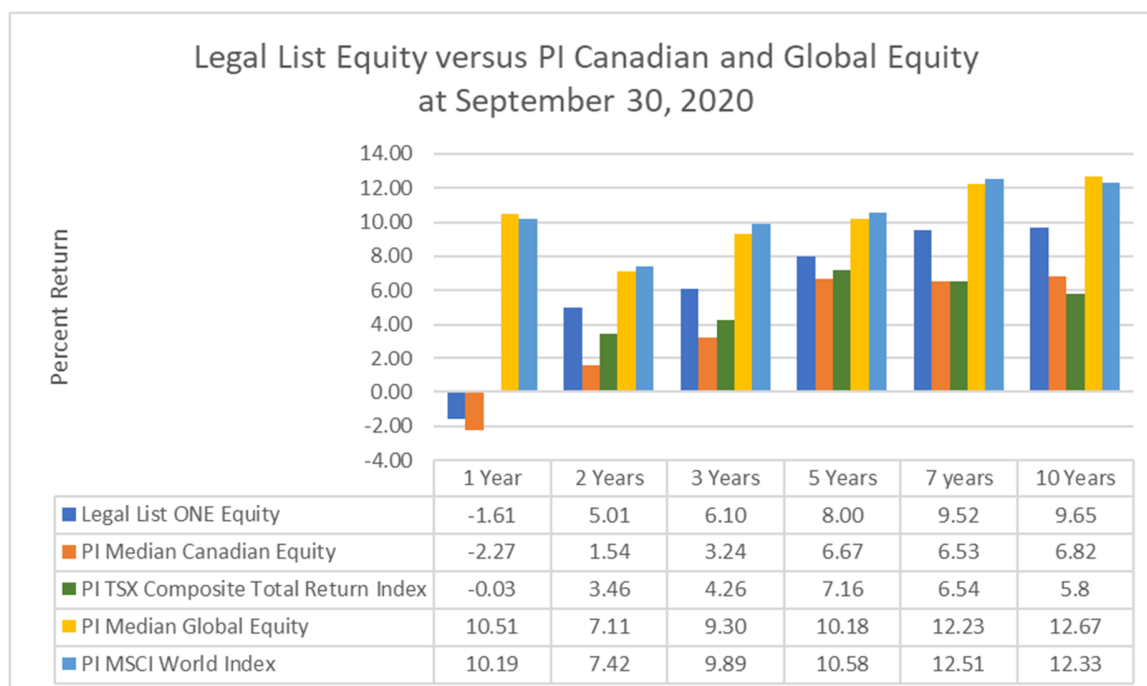
As these charts demonstrate PPN's based on the Price Index will substantially underperform the Total Return Indexes in all periods due to the absence of dividends.

The return of the ONE Equity Fund has been strong since its inception in 2007, despite the sector concentrations of the Canadian equity markets. The following chart shows the return of the ONE Equity fund compared to the fund's custom benchmark and the TSX Composite Total Return Index, the TSX Composite Price Return Index and the Median Canadian equity institutional fund.

The ONE equity fund is the only equity investment that complies with the legal list.



The current legal list does not allow for equity investments outside of Canadian corporations. Non-Canadian investment would be allowed under PI. Historically non-Canadian equity investments have provided for greater diversification and exposure to industries not available in Canadian markets. These benefits have resulted in significantly higher returns from global equities, when measured in Canadian dollars.



Conclusions

Within the legal list investments, the self-managed and professionally managed short term portfolio have had a similar performance profile. However once the investments are extended to the mid and long term sectors of the fixed income markets, the professionally managed legal list performance was significantly better.

But when we consider the option of moving to PI, the ability to earn significantly higher risk adjusted returns, in both fixed income and equity, becomes apparent.

Corporate Policy and Procedure



Policy	Investment Policy
Category	Corporate
Authority	Finance
Related Policies	N/A
Approved By	Council
Effective Date	Tuesday, June-05-2018
Revision Date	Monday, February 22, 2021

Policy Statement

The City of Guelph strives for the optimum utilization of its cash resources within statutory limitations and the basic need to protect and preserve capital, while maintaining solvency and liquidity to meet ongoing financial requirements.

Purpose

~~Click to insert purpose of policy~~ To outline the investment goals and objectives of the City of Guelph and define the parameters within which staff may invest funds not required immediately.

Definitions

Asset Backed Securities: fixed income securities (other than a government security) issued by a Special Purpose Entity, substantially all of the assets of which consist of Qualifying Assets.

Credit Risk: the risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Diversification: a process of investing assets among a range of security types by sector, maturity, and quality rating.

Duration: a measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

Interest Rate Risk: the risk associated with declines or rises in interest rates which cause an investment in a fixed-income security to increase or decrease in value.

Liquidity: a measure of an asset's convertibility to cash.

Market Risk: the risk that the value of a security will rise or decline as a result of changes in market conditions.

Market Value: current market price of a security.

Master Repurchase Agreement: an agreement between a dealer and a client which substantiates that the securities the client receives under a repurchase agreement are the property of the client in the event of a dealer failure.

Maturity: the date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity".

ONE Fund – The One Investment Program ("ONE Fund"): A local government investment pool in which Ontario municipalities may invest. ONE Fund is operated by Local Authorities Service Limited (a wholly owned subsidiary of the Association of Municipalities of Ontario), together with CHUMS Financing Corporation (a wholly owned subsidiary of the Municipal Finance Officers' Association of Ontario).

Portfolio: collection of securities held by an investor.

Prudent Person Rule: an investment standard outlining the fiduciary responsibilities relating to the investment practices of public fund investors.

- a) The standard of prudence to be used by investment managers shall be the prudent person standard and shall be applied in the context of managing an overall portfolio.
- b) The prudent person must act in all matters regarding investments with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.
- c) The prudent person must diversify the investments of the Funds so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so.

Qualifying Assets: financial assets, either fixed or revolving, that, by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

Rate of Return: the yield obtainable on a security based on its purchase price or its current market price. Yield reflects coupon, term, liquidity and credit quality.

Repurchase Agreement: an agreement between a dealer and client to sell a security and to repurchase that security, with interest, at a later date.

Safekeeping: holding of assets (e.g., securities) by a financial institution.

Securities: include bonds, debentures, treasury bills, commercial paper, repurchase agreements, promissory notes and asset-backed securities.

Sinking Fund: money accumulated on a regular basis in a separate custodial account that is used to redeem debt securities or preferred stock issues.

Special Purpose Entity: a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle the holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company.

Weighted Average Maturity (WAM): the average maturity of all the securities that comprise a portfolio.

Scope

The Investment Policy applies to all financial assets of the City of Guelph held within the following:

- General Funds;
- Reserve Funds; and
- Funds held in Trust with the City of Guelph.

Objectives

The primary objectives of the Investment Policy, in priority order, shall be:

- A. Adherence to statutory requirements;
- B. Preservation of capital;
- C. Maintaining liquidity; and
- D. Earning a competitive rate of return.

A) Adherence to Statutory Requirements:

All investment activities shall be governed by the Municipal Act as amended. Investments, unless limited further by Council, will be those deemed eligible under Ontario Regulation 438/97 or as authorized by subsequent provincial regulations.

B) Preservation of Capital:

Safety of principal is an important objective of the Investment Program. Investments of the City shall be undertaken in a manner that protects and preserves the capital of the portfolio. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. Staff shall endeavour to mitigate credit risk and interest rate risk as follows:

Credit Risk:

- Limiting investments to safer types of securities;
- Diversifying the investment portfolio so that potential losses on individual securities will be minimized; and
- Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City does business.

In determining the composition of the portfolio, it will be recognised that the combination of several different investments (diversification) is likely to provide a more acceptable level of risk exposure than having a single investment. As a result, some reasonable diversification of the portfolio will be undertaken. To attain this goal, the City will undertake to establish limitations with respect to credit and investment size.

Investment Quality

All investments shall have a minimum rating within the limitations as set out in Schedule 1. In addition, investments are further restricted by credit rating limitations as outlined in this policy.

1. The City shall not invest in a security offered by any Borrower (except City/Municipal Notes) with a bond rating lower than 'A' as established by Dominion Bond Rating Services (DBRS) or their equivalent ratings provided by Moody's Investor Services (Moody's), Fitch Ratings (Fitch), or Standard & Poor's (S&P).
2. The City shall not invest in securities with a Commercial Paper/ST debt rating lower than R-1 Mid (except Financial Institutions in Schedule I with ratings no lower than R-1 Low) as established by DBRS or their equivalent ratings provided by Moody's, Fitch, or S&P.

Publications of the relevant credit rating agencies shall be monitored on an ongoing basis. Should a rating change result in increased risk with respect to established limitations, an exception report must be prepared and reviewed by the Treasurer with the appropriate action taken to ensure the City's portfolio remains within the limitations and terms outlined in this policy.

Investment Diversification

Institutional exposure limitations have been established to reflect the relative safety of various issuers and the maximum desired exposure to various levels of government and financial institutions.

Diversification will include sector limitations outlined in Schedule I to this policy. All eligible investments (excluding cash held in the bank accounts of the City of Guelph) must adhere to the institutional sector limits as established under Schedule I.

C) Maintaining Liquidity:

The investment portfolio shall remain sufficiently liquid to meet all operating and cash flow requirements and limit temporary borrowing requirements. This shall be done, where possible, by structuring the portfolio such that securities mature concurrent with anticipated cash demands. Furthermore, since all possible cash demands cannot be anticipated, the portfolio shall consist largely of securities with active secondary or resale markets. A portion of the portfolio may be placed in eligible investment pools which offer liquidity for short-term funds.

D) Earning a Competitive Rate of Return:

The rate of return on the investment portfolio will be optimized to the extent possible given the investment objectives of legality, safety of principal and the need to maintain adequate liquidity. Return on investment is of secondary importance compared to the safety and liquidity objectives described above.

Normally longer term investments offer higher yields than shorter term investments. Investments will be made to obtain the most advantageous yields while at the same time ensuring that funds can be made available to meet expected cash requirements. The composition of the portfolio, including its term and class of investments will be adjusted within the guidelines of this policy to take advantage of market opportunities which arise to enhance the rate of return on the portfolio.

Performance Standards/Benchmarking

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return throughout the budgetary and economic cycles, commensurate with the investment risk constraints and cash flow needs of the City. The market yields should be higher than the rate given by the City's general bank account.

Eligible Investments

The City will only invest in securities permitted under the Municipal Act and Ontario Regulation 438/97, as amended from time to time.

Only Canadian dollar investments are authorized for the purposes of this policy within the limitations set out in Schedule I.

Authorized Investment Dealers

The City may invest funds through the investment arm of various Schedule I banks. The following Schedule I banks are authorized to be the City's primary investment dealers:

1. RBC Royal Bank
2. BMO Bank of Montreal
3. CIBC
4. TD Bank Financial Group
5. Scotiabank (The Bank of Nova Scotia)
6. National Bank of Canada

The City may invest funds directly through the administrators of the identified sectors in Schedule I at the approval of the Treasurer and/or Deputy Treasurer subject to the Schedule I limits for those sectors. If the City, at any given point in time, is not in accordance to the Schedule I limits it will have one year to correct the sector balances and become compliant.

Standard of Care

A) Prudence

Investments shall be made with judgment and care, under circumstances then prevailing, following the prudent person principle of investment management and considering the probable safety of their principal as well as the probable income to be derived. Consideration will be given to obtaining independent legal and/or financial advice in circumstances in which the municipality believes additional expertise is warranted.

Investment staff acting in accordance with written procedure, this investment policy and exercising due diligence, shall be relieved of personal responsibility for an individual security's credit risks or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidation or the sale of securities are carried out in accordance with the terms of this policy.

B) Ethics and Conflicts of Interest

Staff involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment policy, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall not undertake personal investment transactions with the same individual with whom business is conducted on behalf of the City.

C) Delegation of Authority

The Investment Policy and any amendments thereto must be adopted by City Council. This policy will delegate to the Treasurer the authority to make investments which comply with this policy, pursuant to section 418(5) of the Act. The Treasurer has overall responsibility for the prudent investment of the City's portfolio.

Investment Procedures and Internal Control

The Treasurer will be responsible for the development and maintenance of suitable procedures to provide for the effective control and management of investments. The procedures include the following requirements:

- The Treasurer or designate is authorized to obtain a reasonable number of quotations with the approved institutions on any individual investment transaction prior to the decision to invest in a transaction on behalf of the City of Guelph;

- All investments are confirmed by signature of the individual making the investment and ratified by signatures of either the Treasurer or the Deputy Treasurer;
- All cash management transactions are recorded and interest earnings distributed to the various funds, as the case may be, in accordance with City policies and generally accepted accounting principles for Ontario municipalities;
- Periodic audits are carried out to determine whether or not the investment guidelines provided by this policy are being followed. An external audit is carried out to evaluate the adequacy of internal controls; and
- Provision is made to obtain insurance coverage at all times to guard against any losses that may occur due to misappropriation, theft or other acts of fraud by employees.

Reporting to Council

In accordance with legislation, submit to Council at least twice per year, a report on the financial position, investment performance, market value and compliance status of the portfolio. The investment report will include reporting requirements and should include:

- A summary, by amount and percentage, of the composition of the investment portfolio;
- Monthly investment balances;
- Year-end balance; and
- Such other information that City Council may require or that, in the opinion of the Treasurer, should be included.

D) Safekeeping and Custody

All investments shall be held for safekeeping in the name of the City of Guelph by financial institutions approved by the City. The depository shall issue a safekeeping receipt to the City for each investment transaction, listing the specific instrument, rate, maturity and other pertinent information. On a monthly basis, the depository will provide reports which list all investment activity, the book value of holdings, the market value as of month-end and income earned by the investments.

Collateralization

In order to mitigate the City's exposure to credit risk, the City will only invest in Bank Sponsored asset-backed securities and repurchase agreements having satisfactory collateralization in place. The level of collateralization for these investments must be at least 100% of their market value.

Review

This policy will be reviewed at every change in Council and/or as needed.

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Schedule 1 – Authorized Investments and Limitations at Time of Purchase

Sector ¹	Minimum DBRS Credit Rating ² Short-term	Minimum DBRS Credit Rating ² Long-term	Maximum Term (years)	Maximum Credit Exposure Individual Limit by Credit Rating	Maximum Credit Exposure Portfolio Limit (max)
Federal – Government of Canada	N/A	N/A	20	100%	100%
Federal – Federal Guarantees	N/A	N/A	20	100%	50%
Provincial Government and Provincial Guarantees	R-1 high R-1 mid R-1 low	AAA AA low A low	20 20 7	75% 75% 50%	75%
Country other than Canada	N/A	AA low	1	5%	5%
Municipal – City of Guelph	N/A	N/A	N/A	N/A	50%
Municipal – Other Municipalities and OSIFA Infrastructure Ontario	N/A	AAA AA low	10	50% 40%	50%
Municipal – Other Municipalities and OSIFA Infrastructure Ontario	N/A	A low	5	10%	10%
School Boards	N/A	AA low	2	10%	20%
University in Ontario, Board of Governors of a College	N/A	AA low	2	10%	20%

¹ Per definitions and restrictions contained in Ontario Regulation 438/97.

² Equivalent ratings from Moody's Investor Services, Standard and Poor's or Fitch Ratings are acceptable as well.

Sector¹	Minimum DBRS Credit Rating² Short-term	Minimum DBRS Credit Rating² Long-term	Maximum Term (years)	Maximum Credit Exposure Individual Limit by Credit Rating	Maximum Credit Exposure Portfolio Limit (max)
Local Board or Conservation Authority	N/A	AA low	2	10%	20%
Board of a Public Hospital	N/A	AA low	2	10%	20%
Non-profit Housing Corporation, Local Housing Corp.	N/A	AA low	2	10%	20%
Financial Institutions – Schedule I Banks	R-1 low	AA low	10	75%	75%
Financial Institutions – Schedule II & III Banks	R-1 mid	AA low	5	25%	25%
Financial Institutions – Credit Unions	N/A	N/A	2	10%	10%
Financial Institutions – Loan/Trust Corporations	R-1 high	AA low	1	5%	5%
Supranational Financial Institution or Supranational Government Organization	N/A	AAA	5	25%	25%
Asset Backed Securities ³	R-1 high	AAA	5	25%	25%
Corporate Debt	N/A	AAA AA low	5 >5	25% 15%	25%
Commercial Paper	R-1 mid	N/A	1	15%	15%
Joint Municipal Investment Pools – Corporate Bond Fund	N/A	N/A	N/A	15% 40%	15% 40%

³ Canadian Bank administered with a minimum of 2 credit ratings.

Sector ¹	Minimum DBRS Credit Rating ² Short-term	Minimum DBRS Credit Rating ² Long-term	Maximum Term (years)	Maximum Credit Exposure Individual Limit by Credit Rating	Maximum Credit Exposure Portfolio Limit (max)
<u>Joint Municipal Investment Pools – Government Bond Fund</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>40%</u>	<u>40%</u>
Joint Municipal Investment Pools – Equity	N/A	N/A	N/A	5% <u>20%</u>	5% <u>20%</u>
Portfolio Term to Maturity	N/A	N/A	ST – 1 LT – 10	N/A	N/A

Prudent Investor Standard Analysis and Recommendations

Municipal Investments Legislation

Municipal Act, Section 418 and Part I of Ontario
Regulation 438/97 (legal list)

- Eligible investments:
 - Bonds issued by Canadian federal, provincial and municipal governments and associated entities
 - Short-term fixed-income securities issued by Canadian chartered banks and credit unions
 - Canadian equities (only accessible through ONE Investment Canadian Equity portfolio)
- Default position for municipal investing
- Basis for City Investment Policy (approved by Council)
- Treasurer responsible for compliance with Investment Policy

Municipal Investments Legislation

Municipal Act, Section 418.1 and Part II of
Ontario Regulation 438/97 (Prudent Investment)

- Can invest in any security
- Governance options are to form an Investment Board (IB) or join a Joint Investment Board (JIB)
 - Municipalities who have greater than \$100 million in funds not immediately required, or greater than \$50 million in net financial assets can choose either option
 - Municipalities who do not meet one of the above criteria can still join a JIB
- Council approves Investment Policy
- JIB responsible for creating and implementing investment plan and for compliance with Council-approved policy
- By-law required to opt-in; legislation change to opt-out

ONE Investment

- Formed in 1993 by Local Authority Services and CHUMS Financing Corp to provide municipal investment options
- Operates two bond portfolios and two equity portfolios:
 - Canadian Corporate Bond Fund (legal list compliant)
 - Canadian Government Bond Fund (legal list compliant)
 - Canadian Equity Fund (legal list compliant)
 - Global Equity Fund (Prudent Investor only)
- Also operates short-term high interest savings account and money market portfolio
- Operates a JIB with six current members (only JIB currently in existence)

Options Considered

- Continue to invest under legal list and continue to self-manage most of the portfolio
- Continue to invest under legal list but expand the managed portion of the portfolio
- Opt-in to Prudent Investor (PI) and form an IB
- Opt-in to PI and join the ONE JIB

Consultant Findings

- Risk adjusted investment returns could be increased by opting-in to PI because of access to global equity markets which are more diversified than Canadian equity markets and have historically outperformed Canadian equity markets.
- Higher returns under the legal list could be achievable through expansion of the professionally managed portion of the City's portfolio as historical analysis demonstrated that the ONE funds outperformed the City's self-managed investment returns.

Note: Recommendations are based on analysis of historical performance which does not guarantee future returns.

City Readiness for Prudent

- The City meets both of the financial criteria required to opt-in to PI.
- Significant progress made toward developing foundational structures through reserve and reserve fund strategy and capital funding strategies.
- Continued development of long-term cash flow forecasting function is required.
- Development of a new Investment Policy required to reflect expanded investment options under PI is needed.

Staff Recommendations

- Continue the work to ready the City for implementation of the JIB option under PI and report back to Council within two years.
- Amend current investment policy immediately to increase access to professionally managed ONE portfolios as an interim step.

Questions?

Staff Report



To	Committee of the Whole
Service Area	Office of the Chief Administrative Officer
Date	Monday, February 1, 2021
Subject	2020 Internal Audit Summary and 2021 Work Plan

Recommendation

That the report titled '2020 Internal Audit Summary and 2021 Work Plan' be approved.

Executive Summary

Purpose of Report

To provide the Committee of the Whole-Audit a summary of Internal Audit activities for 2020 and to outline our plan for 2021 and subsequent years.

Key Findings

- In April 2020, Internal Audit was placed on emergency leave because of the pandemic situation and returned to full capacity in July. Because of the time constraints faced, some activities that were to be completed in 2020 have been deferred until 2021.
- The Audit Plan (The Plan) has been reshaped in order to better align our activities with the Strategic Plan and risk environment highlighted during the pandemic.
- The Plan for 2021 will include a combination of annual core audits (cash handling review of a specific service area department, Driver Certification Program), completion of three audits carried forward from the 2020 plan, and two new engagements, namely; Data Analytics Pilot Project and as project lead for the 2021 Service Rationalization Review.
- The Plan complies with the City of Guelph's internal audit charter and supports the City's Strategic Plan.
- All internal audit activities are performed in an independent, collaborative and objective manner.
- In 2021, Internal Audit will begin to outline a new framework for audit selection and review that is tied to our Strategic Plan and the related budget and action plans. The collaborative approach will give both Senior Management and the Audit Committee greater clarity and insight into our planned activities going forward into 2022.

Financial Implications

N/A

Report

Background

A system of internal controls assists management staff in meeting their responsibilities for the efficient and effective operation of an organization. A well-managed control function is dependent upon many factors to ensure that key business objectives are met, they include; well-documented policies and procedures, clearly defined management responsibilities, external audits of financial information and systems, and internal audits of programs, systems, and processes. In order to ensure an effective control function these components must work together in a mutually supportive manner.

Internal Audit is one key element in a system of internal controls that are part of the City's management practices. Internal Audit provides an independent, objective assurance and consulting activity that, together with management practices and external audits, ensures that programs and services are delivered efficiently, effectively, and in compliance with internal policies and external regulations.

In 2020, Internal Audit's activities included administrative and organizational tasks to research and develop future audit projects for 2021 and beyond, compliance/process and follow-up audits and control consultations. Activities in each of these categories are briefly described below. In addition to the summary of work activities for 2020, we have outlined our work plan for 2021 and have proposed areas for future audits beginning in 2022 (see Attachment 1 – Internal Audit Work Plan 2021 and Attachment 2 – Long Term Audit Plan 2022-2024).

Preamble

In January 2020, Karl Hutchinson assumed the role of General Manager, Internal Audit upon the retirement in late 2019 of the previous Internal Auditor. In April 2020, the Internal Audit department was placed on emergency leave due to the COVID-19 pandemic and returned to full capacity in July 2020. As a result, some of the planned projects that were part of the approved 2020 Audit Plan have had to be deferred until 2021. Those projects include; payroll follow-up audit, cash handling review, IT security review and the capital budget process review.

These projects have been included in the 2021 Internal Audit Work Plan, with the exception of the capital budget process review, which has been replaced by a project management office follow-up audit for 2021. The reason we replaced the capital budget process review was due to the recent implementation of the new budgeting process by our Finance department and to allow some time for maturity of these new processes. By reviewing the project management office in 2021, we will invariably touch upon some of the capital budgeting issues that are more pressing during this time of economic stress.

2020 Internal Audit Activity Summary

Administrative and Organizational

Internal Audit is part of the weekly Corporate Management Team (CMT) meetings in addition to 1:1 and quarterly meeting updates with the Chief Administrative Officer (CAO), Executive Team (ET) and the Chair of the Audit Committee. These meetings give Internal Audit greater clarity and insight into both the day-to-day and the long-term strategic activities of the City.

Internal Audit uses these meetings to help build our Internal Audit Work Plan and to gain feedback from our stakeholders which allows us to address issues on a more real-time basis, where it makes sense to do so.

Future Planning

As the pandemic risk environment evolved, it became clear that our previous audit plan needed to be adjusted to more closely align with this new risk environment and the City's strategic plans going forward. In 2020, we began to develop audit programs for such areas as:

- Business Continuity Management
- Capital Project Management
- Supply Chain Management
- Contract Management Process
- Health and Safety Process Changes
- IT Cybersecurity and General Controls
- Return to Work Process Changes
- Management Monitoring Processes

As we move forward in 2021, these audit areas will be further developed as part of our goal to build an inventory of audit programs and will be added to our Audit Plan going forward into 2022-2024.

Data Analytics Pilot Project

Internal Audit has begun investigating opportunities to utilize advanced financial analytics through a third-party provider. The program is meant to provide insight into vast amounts of financial (general ledger) data and to identify "high-risk" areas for further investigation. This kind of analysis is not possible through traditional sampling techniques. In doing so, we begin to develop an objective and sustainable program that can start to drive decision making and provide enhanced controls to identify potential fraudulent transactions and process gaps.

We have tentatively scheduled this activity as a "pilot project" for 2021 to ascertain the value derived from it and the logistics of sustaining the project going forward.

Program Review Framework Development

As our understanding of the City and its processes has grown over the year, we realized that in order to better align our department it only makes sense that we incorporate the Future Ready Strategic Plan and related action items as part of our Audit Plan going forward.

We have proposed that our Audit Plan in 2022 utilize the Strategic Plan pillars and the related action items to build a defined process for audit area selection. These audits could be some combination of; operational, strategic, value for money and compliance. For example, we may choose to do a review of our Fleet Operations "program", which may combine elements listed above. These reviews would be completed through the use of an outside consultant, with primary oversight by Internal Audit.

As we move forward in 2021, Internal Audit has planned update meetings with our Executive Team to outline what this new framework could or should look like. The high-level objectives of these reviews would be to answer the following questions:

1. Are appropriate results being achieved? Is this an effective program?
2. Are we achieving results in an efficient manner? Are we getting good value for the money invested?
3. Are the associated risks managed effectively? Is there a process in place to identify risks and are there control systems and processes in place to assist us in mitigating risks in an efficient manner?

Internal Audit and the department in question would jointly develop the more detailed scope and objectives. We would then issue an RFP to select the review consultant. At the conclusion of the review, Internal Audit would issue a summary report to the Audit Committee and attach the consultant report as part of the reporting package.

The recommendations that flow from these reports could also be supported by our Continuous Improvement Group to assist departments with the implementation activities required.

Control Consultations

Internal Audit's role, in addition to that of compliance, can include consulting engagements. Consulting engagements allow internal auditors to play more of an advisory role than traditional compliance engagements, whose primary purpose is to provide an opinion on whether or not organizations goals are being accomplished using an agreed upon set of standards. The caveat for doing these types of engagements is to ensure that the Internal Audit function remains independent of management functions. That is, while Internal Audit gives advice and recommendations of possible appropriate actions, management performs implementation.

In 2020, Internal Audit provided advice to assist senior management in evaluating options for control testing at Our Energy Guelph in 2021. Internal Audit also provided advice to Clerks regarding records retention policies.

Lastly, Internal Audit performed a high-level financial review of the budget submission from The Elliott and have provided recommendations to assist Public Services and Finance in appropriate go-forward measures.

Compliance and Process Audits

Three compliance/process audits were completed in 2020, namely, the Employee Expense Process Audit, Fleet Inventory Audit and the Driver Certification Program (DCP) Audit for Guelph Transit. With the exception of the DCP Audit, the results of these audits have been reported to senior management and the Audit Committee. The DCP Audit (Transit) will be reported as an information report in February 2021. We're currently in progress on a second DCP Audit for Operations, with completion expected in Q1 2021 and will likely go as an information report as well.

Currently, we are in progress on three compliance audits; the annual Cash Handling Audit (Recreational Facilities), the Payroll Follow-Up Audit, and the DCP for Operations audit.

Status Report on Outstanding Audit Recommendations

As per our Internal Audit Quarterly Status Report Procedure, we would normally issue three updates to the Audit Committee and/or Council per year. However,

because of the pandemic and our emergency leave situation, we were only able to issue one update to the Audit Committee in 2020.

In general, the completion rate is quite good at approximately 89% of audit recommendations implemented by management. We would, however, like to see some more progress on the recommendations that are being held up by future systems implementation, and will be following up with those stakeholders to provide more detail to the Audit Committee by the end of 2021.

Financial Implications

N/A

Consultations

The Executive Team has been consulted and supports the proposed activities going forward.

Strategic Plan Alignment

The 2021 Internal Audit work plan supports the Strategic Plan – Working Together for our Future pillar. Through projects identified, Internal Audit will utilize a systematic and disciplined approach to evaluate and improve the effectiveness and efficiency of the City's governance, risk management and internal controls.

Attachments

Attachment-1 2021 Internal Audit Work Plan

Attachment-2 Long Term Audit Plan 2022-2024

Attachment-3 Internal Audit Independence Confirmation

Report Author

Karl Hutchinson, General Manager Internal Audit

This report was approved by:

Karl Hutchinson

General Manager, Internal Audit

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This report was recommended by:

Scott Stewart

Chief Administrative Officer

Office of the Chief Administrative Officer

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2021 Internal Audit Work Plan

Name of Project	Type of Audit	Reporting Timeline
Service Rationalization Review Internal Audit will act as project lead coordinator. The third party consultant will assess the City's core services in aid of finding efficiencies within the City's scope of responsibility.	Third Party Service Review	Final Report to be issued in September 2021
Data Analytics Pilot Project To assess the degree of financial risk in City's general ledger financial system and provide insight to assess future financial areas for audit.	Operational/Value for Money	December 2021
Program Review Framework Development To develop a systematic audit selection and review process with the Executive Team.	Not applicable	Update report to Audit Committee in December 2021
Project Management Office Follow-Up Audit To assess the effectiveness and efficiency of the PMO's internal controls and processes and compliance to policies, procedures, legislation and By Laws.	Compliance	TBD
Payroll Audit Follow-Up Audit To assess the effectiveness and efficiency of the processes and compliance to policies, procedures and legislation.	Compliance - In Progress	TBD
Annual Driver Certification Program Compliance Audit-Guelph Transit To access compliance to the Ministry of Transportation criteria.	Compliance	September 2021 CoW Meeting
Annual Driver Certification Program Compliance Audit-Fleet Operations To access compliance to the Ministry of Transportation criteria.	Compliance	Compliance Report - January 2022
Annual Cash Handling Process Audit – REC To assess the effectiveness and efficiency of the processes and compliance to policies, procedures, legislation and By Laws.	Operational – In Progress	TBD
Status Report on Outstanding Audit Recommendations Provides an update to the Audit Committee on management's implementation status of recommendations agreed upon by staff.	Not applicable	April/June/September CoW Meetings

Long Term Audit Plan 2022-2024

Possible Project	Strategic Plan Pillar	Department(s)
Annual Program Review 1 To provide an objective evaluation of the effectiveness and efficiency of the program and to provide an assessment as to the identification and management of risk. Risk is defined as events that could potentially prevent the program from achieving the program goals.	TBD	TBD
Annual Program Review 2 To provide an objective evaluation of the effectiveness and efficiency of the program and to provide an assessment as to the identification and management of risk. Risk is defined as events that could potentially prevent the program from achieving the program goals	TBD	TBD
Annual General Ledger Review Using advanced data analytics tools, we will identify high-risk areas/transactions for follow-up by our Finance department.	All	Finance
Business Continuity Management	Working Together for our Future	TBD
Capital Project Management	Working Together for our Future	Project Management Office
Supply Chain Management	Working Together for our Future	Finance, Procurement
Contract Management Process	Working Together for our Future	Legal, Finance
Health and Safety Process Changes	Working Together for our Future	All
Cybersecurity	Working Together for our Future	IT
IT General Controls Review To ensure the integrity of the data and processes that the systems supports. ITGG's are the basic controls that can be applied to IT systems such as, applications, operating systems, databases and IT infrastructure.	Working Together for our Future	IT
Return to Work Process Changes	Working Together for our Future	All
Management Monitoring Processes	Working Together for our Future	All

Possible Project	Strategic Plan Pillar	Department(s)
Annual Driver Certification Program Compliance Audit-Guelph Transit To access compliance to the Ministry of Transportation criteria	Working Together for our Future	Operations
Annual Driver Certification Program Compliance Audit-Fleet Operations To access compliance to the Ministry of Transportation criteria	Working Together for our Future	Operations
Annual Cash Handling Process Audit To assess the effectiveness and efficiency of the processes and compliance to policies, procedures, legislation and By Laws	Working Together for our Future	TBD
Status Report on Outstanding Audit Recommendations Provides an update to the Audit Committee on management's implementation status of recommendations agreed upon by staff.	N/A	Multiple

Annual Declaration for 2020

Introduction

This declaration is to be signed annually by all Internal Audit staff and service provider personnel. It covers:

1. Conformance to the City of Guelph Values.
2. Conformance to the City of Guelph Code of Conduct.
3. Conformance to mandatory internal auditing requirements, including the IIA Code of Ethics.
4. Conformance to Internal Audit policies and procedures.
5. Conflicts of interest.
6. Completion of professional development requirements for Internal Auditors of minimum 40 hours each year.

1. City of Guelph Values

I declare I have conformed to the City of Guelph Values:

- Integrity
- Service
- Inclusion
- Wellness
- Learning

2. City of Guelph Code of Conduct

I declare I have conformed to the City of Guelph Code of Conduct requirements.

3. Mandatory Internal Auditing requirements, including the IIA Code of Ethics

I declare I have conformed to mandatory internal auditing requirements:

- Core Principles for the Professional Practice of Internal Auditing
- Definition of Internal Auditing
- International Standards for the Professional Practice of Internal Auditing
- IIA Code of Ethics

I declare I have conformed to the IIA Code of Ethics principles:

- Integrity – The integrity of Internal Auditors establishes trust and thus provides the basis for reliance on their judgment.
- Objectivity – Internal Auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

- Confidentiality – Internal Auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.
- Competency – Internal Auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

4. Internal Audit Policies and Procedures

I declare I have conformed to policies and procedures contained in the Internal Audit Manual.

5. Conflicts of Interest

Conflict of interest is a situation in which an Internal Auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfil duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the Internal Auditor, the Internal Audit activity, and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.

Internal Auditors are not to provide audit services for work for which they may previously have been responsible. Internal Audit may provide assurance services where they had previously performed consulting services, provided the nature of the consulting did not impair objectivity, and provided individual objectivity is managed when assigning resources to the engagement.

Instances of perceived or actual conflict of interest by Internal Audit staff and service providers shall immediately be reported it to the Chief Audit Executive or the Chair of the Audit Committee.

I declare I have:

Not had any conflicts of interest.

6. Professional Development

I declare I completed the professional development requirements for Internal Auditors of minimum 40 hours each year.

Declaration

I declare I have conformed to all requirements of this Annual Declaration for the period January 1, 2020 to December 31, 2020.

I declare that if an issue arises in relation to any of the six areas contained in this Annual Declaration in the coming year, I shall immediately report it to the Chief Audit Executive or the Chair of the Audit Committee, as applicable.

Name: Karl Hutchinson

Job Title: General Manager, Internal Audit

Date: December 31, 2020

Name: Rob Jelacic

Job Title: Internal Audit Specialist

Date: December 31, 2020