

The Corporation of the City of Windsor

Liquidity Management Review

Internal Audit Summary Report

February 24, 2021

This report was developed in accordance with our engagement letter addendum dated January 24, 2020 and is subject to the terms and conditions included therein.

Our work was limited to the specific procedures and analysis described herein and was based only on the information made available at the time we prepared the report. Accordingly, changes in circumstances after the date of this Report could affect the findings outlined herein. We are providing no opinion, attestation or other form of assurance with respect to our work and we did not verify or audit any information provided to us. This information has been prepared solely for the use and benefit of and pursuant to a client relationship exclusively with the Corporation of the City of Windsor. PwC disclaims any responsibility to others based on its use and accordingly this information may not be relied upon by anyone other than the Corporation of the City of Windsor.



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Point of view - Sprint 1



Project POV: Liquidity stress events may not be appropriately mitigated if key liquidity metrics are not measured, monitored and mitigated through strong liquidity management practices.

00

Sprint 0 POV

Liquidity management policies are conservative in nature as a result of the pay-as-you-go strategy. Liquidity management practices demonstrate alignment across all planning functions, and are implemented in a reasonable manner as demonstrated by June 2020 S&P credit scores and AA rating.

01

Sprint 1 POV

Management has the capabilities to measure key liquidity metrics over both a medium term (3-12 month) and long term (18-48 month) horizon but these metrics are not frequently measured or reported to allow stakeholders to make decisions based on internal trends and peer comparisons¹.

02

Sprint 2 POV

Cash flow models and budgeting systems are designed to accommodate flexible scenarios while capturing assumptions and decisions. Opportunities exist to utilize existing models to implement liquidity risk tolerances and targets, improving measurement and monitoring of early warning signals to inform liquidity contingency planning.

Strategic impact

Strong liquidity management practices enhance fiscal sustainability by creating a sound, stable financial position to make decisions.

Status of considerations for management

| Consideration for management | Impact | Management status |
|--|---------------------------------------|---------------------------------|
| None noted | NA | NA |
| None noted | NA | NA |
| Establish baseline measurements for selected liquidity metrics, as well as a tolerance and target for each of Council and Administration which will facilitate establishing appropriate monitoring practices and identification of potential early warning indicators. Definition of a liquidity risk tolerance will help the City to prudently manage its liquidity and support the ability to withstand a prolonged period of stress. | Fiscal flexibility and sustainability | Target completion date: Q2 2023 |
| Management should continue to work towards developing a formal liquidity contingency plan that may include the following components: plausible stress events, early warning indicators and monitoring system, stress levels/tolerances, alternative funding sources, funding strategies, crisis management team, action plan, cash flow planning and scenario process. | | |

¹As detailed in the Appendix, four municipalities were selected from across Canada to conduct a peer analysis using publicly available information at a point in time. Readers should not place undue reliance on the information presented in this report, as actual results over a period of time may differ materially.

Overall management comments

Management will continue to assess if additional metrics within the annual financial statements report would be useful and are considered warranted and will continue to enhance existing budget development processes to look for opportunities to include additional leading indicators to what is currently in practice. There are a number of different strategies and practices currently in place to manage our liquidity shortfalls, as evidenced through the managing of the COVID-19 pandemic over the past year. Management will consider these strategies to develop a more formalized liquidity contingency plan.

Point of view - Sprint 2

Additional items for management's consideration

The following items were noted and discussed with management as considerations for improvement. They are not required actions; however, they are good practices. Implementing these practices would be innovative in a municipal setting. Such practices are, however, more aligned with basic practices in the broader business markets.

Through a benchmarking exercise¹ conducted to compare the performance of the City to a selected peer group, it was noted that the City demonstrates **strong liquidity metrics**, a higher age of infrastructure, lower tax levy increases, and a higher dependency on transfers from other levels of government. In the pursuit of **long term fiscal sustainability**, the City should continue to set aside funds for asset replacement, evaluate opportunities to adjust tax levies to peer municipalities, and explore other sources of revenue to reduce vulnerability to potential funding cuts. There are also opportunities for the City to enhance **public reporting over fiscal sustainability** to demonstrate the outcomes of liquidity management practices employed to create a sound, stable financial position to make decisions.

Consider selecting a minimum of 4-5 **key liquidity metrics** for more frequent measurement and reporting.

To enhance current **budget assumptions based on key indicators**, consider implementing leading indicators which are measurable and meaningful, and have a material impact on scenario development for budgets and forecasts.

¹As detailed in the Appendix, four municipalities were selected from across Canada to conduct a peer analysis using publicly available information at a point in time. Readers should not place undue reliance on the information presented in this report, as actual results over a period of time may differ materially.

Internal audit project canvas - Sprints 0, 1 & 2

| | | |
|--|--|---|
| <p>Common areas of risk for a liquidity stress event</p> <ol style="list-style-type: none"> 1. Decline in net asset/cash position. 2. Decline in operating revenue. 3. Unidentified impacts on planned operating surplus. 4. Significant impacts from central bank monetary policy. 5. Validity of historical assumptions used in approved budgets and subsequent forecasts. 6. Insufficient scenario analysis and/or consideration of key economic indicators in forecasts and projections¹. 7. Significant capital plan impacts. 8. Insufficient early warning indicator practices. 9. Incomplete liquidity contingency plan or playbook. 10. Significant impact on future tax levy. 11. Impact of any projected deficits from Government Business Enterprises (GBEs). <p>¹ A forecast is based upon assumptions reflecting the conditions a government or entity expects to exist and the course of action reasonably expected to be followed. A projection is prepared to present one or more hypothetical courses of action that the government or entity might follow.</p> | <p>Project drivers to inform conclusions on risk management practices</p> <ul style="list-style-type: none"> • Liquidity horizons over which budgets, forecasts and projections are prepared. • Forecasted fiscal 2020 surplus and supplementary variance analysis. • Cash flow, surplus and capital plan forecasts beyond fiscal 2020. • Statements of recommended practice and common practice for liquidity horizons, forecast methodologies, and metrics. • S&P Global credit rating, and underlying methodology, for City of Windsor, June 3, 2020. • 20-Year Strategic Vision, City of Windsor. • Formal and informal liquidity management practices. • Government and central bank announcements. | <p>Value proposition of the Sprint approach</p> <ul style="list-style-type: none"> • An agile internal audit is intended to provide insights into key risk areas through focused analysis that is based primarily on assessing evidence obtained through interviews and key documents. • By prioritizing areas of key risk through summary reporting, insights and management responses are intended to be more relevant and timely. |
| <p>Key areas of analysis to understand comprehensiveness of liquidity risk management practices</p> <ul style="list-style-type: none"> • Measurement of baseline liquidity metrics using historical financial information. • Analysis of management practices to calculate key liquidity metrics for future oriented financial information over a medium (3-12 month) and long term (18-36 month) horizon. • Benchmark of baseline liquidity metrics and liquidity management practices to relevant common practice. • Identification of potential early warning signals and common good practice for liquidity contingency planning. | <p>Key stakeholders</p> <ul style="list-style-type: none"> • CFO, Treasurer and Deputy Treasurer • Deputy Treasurer, Taxation and Financial Projects • Deputy Treasurer, Financial Planning • Senior Manager of Asset Planning <p>Sprint 1 outcomes</p> <ul style="list-style-type: none"> • Prioritized key liquidity metrics for further analysis. • Selected four municipalities with similar economic indicators to Windsor and compared key liquidity metrics to assess how well Windsor is managing liquidity in comparison to peers. <p>Sprint 2 outcomes</p> <ul style="list-style-type: none"> • Identified key systems and processes used to generate future oriented financial information. • Identified early warning signals and practices and compared to common good practice of regulated entities. | |

Appendix: Benchmarking Exercise

Selection of peer municipalities

The Conference Board of Canada provides regular insights on economic indicators for major cities across Canada. We examined the indicators for 23 Canadian cities, and selected the following four cities for comparison due to similar size and at least 3 of 5 other key indicators being within an acceptable range of similarity.

Key indicators used to select peer municipalities:

- **Population:** the number of residents is an indicator of the number of services a City will provide.
- **Housing starts:** a *leading indicator* that projects the path toward expansion (economic growth) or contraction (recession).
- **Consumer Price Index (CPI):** a measure of the changes in the average price of a typical basket of goods and services purchased by consumers.
- **Personal income per capita:** used to evaluate the standard of living and quality of life of the population.
- **Unemployment rate:** measures the ability of workers to readily obtain gainful work to contribute to the productive output of the economy
- **Real Gross Domestic Product (GDP) %:** represents the value of all goods and services produced by an economy in a given year, excluding inflation.

Table 1:

Source: Conference Board of Canada insights on major cities

| Economic indicators | Windsor-Essex Area <i>Ontario</i> | Regina <i>Saskatchewan</i> | Moncton <i>New Brunswick</i> | Oshawa <i>Ontario</i> | Kingston <i>Ontario</i> |
|------------------------------------|--------------------------------------|-------------------------------|---------------------------------|--------------------------|----------------------------|
| Population (000s) | 356.9 | 265.4 | 157.6 | 419 | 177.2 |
| Housing starts (units) | 1,006 | 1,008 | 933 | 1,398 | 638 |
| Consumer price index (2002 = 1.00) | 1.39 | 1.41 | 1.37 | 1.39 | 1.39 |
| Personal income per capita (\$) | \$46,909 | \$51,640 | \$45,315 | \$48,249 | \$45,967 |
| Unemployment rate % | 8.8 | 9.0 | 8.9 | 7.4 | 7.3 |
| Real GDP % | -4.4 | -7.1 | -2.5 | -3.7 | -3.4 |

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Peer comparison for liquidity management outcomes (metrics)

While Windsor demonstrates strong liquidity metrics in comparison to selected peers, there may be an opportunity to adjust tax levies or debt to a level that is consistent with the selected peers to access additional funding to enhance long term fiscal sustainability.

Key liquidity metrics for credit rating:

- **Interest cost as a % of revenue***: calculated as 2019 consolidated interest cost over 2019 total revenue.
- **Average¹ free cash and liquid assets**: calculated as cash plus short term investments plus accounts (taxes) receivable less financial liabilities² less reserves at December 31, 2019 less 2020 commitments.
- **Average¹ free cash and liquid assets as a % of debt service**: average free cash and liquid assets as calculated above over 2019 consolidated interest cost³.
- **Tax levy increase***: measured as the increase in property taxes from 2018 to 2019.
- **Net assets (debt)***: as indicated on the 2019 audited statement of financial position.
- **Annual surplus**: as indicated on the 2019 audited statement of operations.
- **Reserve levels***: as indicated in the 2019 audited financial statements.
- **Tax-supported debt as a % of operating revenues**: total long term debt from the 2019 audited statement of financial position over 2019 total revenue from the statement of operations.

Table 2:

Source: Audited Financial Statements, S&P

| \$000's (December 2019) | Windsor | Regina | Oshawa | Kingston | Moncton |
|---|--------------------|-----------|--------------------|--------------------|-------------|
| S&P rating | AA | AAA | AAA | n/a | A+ |
| Overall ranking based on key liquidity metrics (see Table 3 for further details) | 1 | 2 | 3 | 4 | 5 |
| Interest cost as a % of revenue | 0.42% | 1.73% | 1.44% | 3.08% | 4.16% |
| Tax levy increase (year-over year) | 2.20% ⁴ | 5.00% | 3.32% ⁴ | 4.15% ⁴ | 3.84% |
| Net assets (debt) | \$189,751 | \$34,859 | \$33,607 | \$(243,363) | \$(125,313) |
| Reserve levels | \$216,293 | \$201,177 | \$94,918 | \$273,719 | \$60,194 |
| Other Metrics | | | | | |
| Line of credit | \$100,000 | \$147,400 | n/a | \$10,000 | \$25,000 |
| % of approved debt limit utilized | n/a ³ | 67.24% | n/a ³ | n/a ³ | 78.91% |
| Employee future benefit liabilities | \$603,261 | \$67,949 | \$53,359 | \$55,525 | \$11,372 |

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¹ Assumed that 2019 reasonably reflected average given purpose of analysis.

² As per audited statement of financial position at December 31, 2019, excludes liabilities for employee future benefits and landfill closure/contaminated site remediation.

³ Annual principal and interest payments required to service long term debt are within the annual debt repayment limits prescribed by the Ministry of Municipal Affairs and Housing and approval by Treasurer's Certificate, By-law or the Ontario Municipal Board was obtained for all debt issuances.

⁴ BMA Management Consulting Inc. 2019 Residential Property Tax Comparisons rank Windsor and Kingston as mid-range in their comparison of relative taxes at \$3,295 and \$3,652 respectively, while Oshawa is ranked as high-range at \$4,581 per detached bungalow.

*select metrics summarized in Table 2

Peer comparison of S&P metrics

Table 3:

Source: Calculated S&P metrics based on S&P Criteria and Methodology For Rating Local And Regional Governments Outside Of The U.S, as well as available information from Audited Financial Statements and Notes

| S&P liquidity metrics: | Ranks* | | | | |
|--|----------------|---------------|---------------|-----------------|----------------|
| | 1st | 2nd | 3rd | 4th | 5th |
| Interest cost as a % of revenue | Windsor | Oshawa | Regina | Moncton | Kingston |
| Average free cash and liquid assets | Windsor | Oshawa | Regina | Moncton | Kingston |
| Average free cash and liquid assets as a % of debt service | Windsor | Regina | Oshawa | Moncton | Kingston |
| Tax levy increases | Regina | Kingston | Moncton | Oshawa | Windsor |
| Net assets / (debt) | Windsor | Regina | Oshawa | Moncton | Kingston |
| Annual surplus | Regina | Kingston | Windsor | Moncton | Oshawa |
| Reserve levels | Kingston | Windsor | Regina | Oshawa | Moncton |
| Tax-supported debt as a % of operating revenues | Windsor | Oshawa | Regina | Kingston | Moncton |
| Overall rating | Windsor | Regina | Oshawa | Kingston | Moncton |

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Peer comparison for liquidity management outcomes (metrics)

There are opportunities for to enhance public reporting over fiscal sustainability to demonstrate the outcomes liquidity management practices employed to create a sound, stable financial position to make decisions.

Windsor's net book value of capital assets-to-cost of capital is one of the lowest of the selected peers, indicating a higher age of infrastructure. The City should continue to set aside funds for asset replacement to enhance flexibility.

While Windsor's sustainability and flexibility metrics are consistent with selected peers, Windsor's higher dependency on government transfers may result from its strategic location as a Canada-US border and transportation hub. Where possible, other sources of revenue should continue to be explored to reduce vulnerability to potential funding cuts from other levels of government.

Key sustainability metrics per PSAB SORP-4:

- **Assets-to-liabilities***
- **Financial assets-to-liabilities***
- **Net assets-to-total annual revenue**
- **Expense by function-to-total expenses**
- **Net assets-to-GDP* or taxable assessment**
- **Accumulated surplus-to-GDP* or taxable assessment**
- **Total expenses-to-GDP* or taxable assessment**

Key flexibility metrics per PSAB SORP-4:

- **Public debt charges-to-revenues:** this is the same metric as the credit rating metric of Interest cost as a % of revenue
- **Net book value of capital assets-to-cost of capital assets***
- **Own-source revenues-to-GDP* or taxable assessment**

Key vulnerability metrics per PSAB SORP-4:

- **Government transfers-to-total revenues***
- **Foreign currency debt-to-net debt:** not considered a key metric for local government

Table 4:

Source: Audited Financial Statements and Notes, using the most reasonable information available.

| \$000's (December 2019) | Windsor | Regina | Oshawa | Moncton | Kingston |
|---|---------------|----------|----------|----------|----------|
| Overall ranking based on key liquidity metrics <i>(see Tables 5, 6 and 7 for further details)</i> | 1 | 2 | 3 | 4 | 5 |
| Assets-to-liabilities | 3.70 | 5.35 | 3.64 | 3.91 | 3.12 |
| Financial assets-to-liabilities | 1.22 | 1.06 | 1.14 | 0.50 | 0.65 |
| Net assets (debt) to GDP | 1.26% | 0.21% | 0.23% | (1.62)% | (2.70)% |
| Accumulated surplus to GDP | 15.49% | 14.03% | 4.30% | 9.48% | 16.29% |
| Total expenses to GDP | 5.30% | 3.93% | 1.28% | 2.35% | 5.53% |
| Net book value of capital assets-to-cost of capital assets | 0.59 | 0.67 | 0.58 | 0.63 | 0.63 |
| Government transfers-to-total revenues ⁵ | 27.14% | 11.45% | 2.24% | 10.16% | 22.72% |

*select metrics summarized in Table 4

⁵ Government transfers for both capital and operating expenditures are included for purposes of this comparison due to information constraints. Note that the City of Regina reported government transfers for operating expenditures to total revenues in their 2019 Annual Report.

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Peer comparison for liquidity management outcomes (metrics) - continued

Sustainability is the degree to which a government can maintain its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others without increasing the debt or tax burden relative to the economy within which it operates.

Table 5:

Source: Audited Financial Statements and Notes, using the most reasonable information available.

| Key sustainability metrics | Rank | | | | |
|----------------------------------|----------------|--------------------------|----------|----------------|-----------------|
| | 1st | 2nd | 3rd | 4th | 5th |
| Assets-to-liabilities | Regina | Windsor | Moncton | Oshawa | Kingston |
| Financial assets-to-liabilities | Windsor | Oshawa | Regina | Kingston | Moncton |
| Net debt-to-total annual revenue | Windsor | Oshawa | Regina | Kingston | Moncton |
| Net assets-to-GDP | Windsor | Oshawa | Regina | Moncton | Kingston |
| Accumulated surplus-to-GDP | Kingston | Windsor | Regina | Moncton | Oshawa |
| Total expenses-to-GDP | Oshawa | Moncton | Regina | Windsor | Kingston |
| Overall rating | Windsor | Oshawa Regina | - | Moncton | Kingston |

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Peer comparison for liquidity management outcomes (metrics) - continued

Flexibility is the degree to which a government can change its debt or tax burden on the economy within which it operates to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others.

Table 6:

Source: Audited Financial Statements and Notes, using the most reasonable information available.

| Key flexibility metrics | Rank | | | | |
|--|---------------------------|---------------------|-----------------|----------------|---------------|
| | 1st | 2nd | 3rd | 4th | 5th |
| Public debt charges-to-revenues | Windsor | Oshawa | Regina | Moncton | Kingston |
| Net book value of capital assets-to-cost of capital assets | Regina | Kingston Moncton | - | Windsor | Oshawa |
| Own-source revenues-to-GDP or taxable assessment. | Kingston | Windsor | Regina | Moncton | Oshawa |
| Overall rating | Windsor Regina | - | Kingston | Moncton | Oshawa |

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Table 7:

Source: Audited Financial Statements and Notes, using the most reasonable information available.

| Key vulnerability metrics | Rank | | | | |
|---|--------|---------|--------|----------|---------|
| | 1st | 2nd | 3rd | 4th | 5th |
| Government transfers-to-total revenues ⁵ | Oshawa | Moncton | Regina | Kingston | Windsor |

⁵ Government transfers for both capital and operating expenditures are included for purposes of this comparison. Note that the City of Regina reported government transfers for operating expenditures to total revenues in their 2019 Annual Report.

Limitations inherent to the internal auditor's work

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses, and if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

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